Regulatory Policy Newsletter

Quarterly Assessment of Regulatory Policy & Market Practice

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Editor: Paul Richards

ICMA International Capital Market Association

– continued

Five years of continuity and change

Foreword by Robert Gray, Vice-Chairman of ICMA

The year just past saw the fifth anniversary of the combination of the International Primary Market Association (IPMA) and the International Securities Market Association (ISMA) to create today's International Capital Market Association (ICMA). A significant result of the merger of the two associations was the establishment of a new Regulatory Policy Committee, which I have had the privilege of chairing, and a new regulatory policy team at ICMA's offices in London. My committee was given responsibility by the Board for setting priorities and working with our members to determine how best to represent our industry's position on regulatory matters in relation to both primary and secondary markets.

At the time of the merger in 2005, a particular concern for IPMA's membership was the uncertainty attaching to the Prospectus Directive; a full year after its implementation date, the Prospectus Directive was the subject of uneven implementation and interpretation in different EU Member States. For its part ISMA was closely tracking the progress of the Markets in Financial Instruments Directive (MiFID) through its Level 2 stage as a founder member of MiFID Connect, a joint industry initiative designed to assist our industry with the practical aspects of MiFID. Similar fears as to the consistency of application of MiFID implementation proved to be well founded.

Both the Prospectus Directive and MiFID have been the subject of separate reviews by the European Commission, which have confirmed the potential for market differences stemming from overly generous discretions afforded to the EU's national regulators. But change is afoot. The European Commission's consultation on the review of MiFID opened on 8 December, and proposes new pan-European requirements beyond those that CESR advised. The Directive to amend the Prospectus and Transparency Directives took effect on 31 December and provides proof of the determination of the authorities to develop the perimeter of regulation, as detailed in this Newsletter. Procedural flexibility will be at the European rather than the national level: in the case of the amending Prospectus Directive it is the European Commission that will be developing

Robert Gray

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further detailed implementing provisions. Market practitioners must also hope that the creation of new regulatory authorities, particularly the European Securities and Markets Authority (ESMA), will also result in a higher level of harmonisation and standardisation of EU supervisory rules across Member States.

In addressing the challenges facing our industry, ICMA's regulatory policy team draws upon a strong legacy from both predecessor associations. That legacy derives from a clear and consistent focus on the workings of our market. ICMA does not seek to provide prescriptions for the global financial system; our focus will remain on the efficiency of the international capital market where we are the standard setter for good market practice, and on ensuring that the regulatory framework in the international capital markets is appropriate to the execution of our members' business. As a former Chairman of IPMA, I have been very gratified by how this tradition of member engagement has been carried forward by the ICMA regulatory policy team. Our reliance on member engagement in order to keep our rules, recommendations and guidelines up to date remains a distinctive feature of our Association.

This Regulatory Policy Newsletter also highlights our Association's work on addressing transparency and documentation issues in the sovereign bond market. Here again ICMA can draw upon a rich vein of previous work. Following the Asian financial crisis, there was growing official support for the concept of a statutory bankruptcy-style regime for developing country sovereign debt. At that time IPMA led industry efforts to combat these proposals and promote the alternative of voluntary, market-based sovereign debt restructuring, underpinned by the introduction of collective action clauses into sovereign debt instruments. To support this initiative we drafted model collective action clauses, which remain part of ICMA's Primary Market Handbook. These model clauses have stood up well over time and should provide the basis from which to formulate new documentation standards for developed country sovereign debt, both within the euro area and beyond. Just one more example of ICMA's commitment to promote standards that will preserve the efficiency and durability of the international capital market in which we all work.

Robert Gray
Chairman, Debt Finance and Advisory, HSBC Bank plc
Vice-Chairman of ICMA and Chairman of ICMA's Regulatory Policy Committee

ICMA: 2010 review and 2011 priorities

Martin Scheck

As we set our priorities for 2011 it is worth looking back briefly at what your Association has done in 2010, undoubtedly our busiest year yet.

Regulatory Policy and Market Practice

The pace of regulatory change affecting our members in 2010 has been unprecedented. We can highlight many initiatives we have taken to help our members in response, and to set standards of good market practice in consultation with our members within the new regulatory framework. For example:

- The questionnaire and resulting report on transparency and liquidity, which we used to respond to CESR.
- Also particularly noteworthy was our work on the problems in the sovereign bond markets which led us to send out a full consultation paper on transparency and investor protection on sovereign issues, with the aim of setting new best market practice.
- The ICMA European Repo Council's White Paper focused on the role of short selling, settlement failures and infrastructure deficiencies in Europe, provoking a strong reaction and hence real progress, detailed in December's annex.
- Responding to initiatives from members, and particularly the smaller financial groups among our membership, we commenced a series of allocation roundtables with issuers, syndicate managers and investors, to address the concerns around certain primary market practices and improve these where possible.
- We were also heavily engaged representing members' views in the revision of the Prospectus Directive – for example, actively recommending against an increase in the €50,000 exemption threshold.
- Work continued apace on the asset side (AIFM Directive together with AIMA, Private Bank Quality Charter, valuation transparency project, governance) and we created the ICMA Issuer Forum for bank treasurers, where a number of interesting topics – such as bank "bail-ins" – have already been discussed in the three meetings held so far.
- We have also been focused on infrastructure issues through the ICMA European Repo Council, AMTE Council and our ECP Committee as well as providing our members' views on the current liquidity proposals for banks.
- The Association continues to run a full range of active Committees and Councils dealing with different market segments, each one with a blend of continental European and London-based members.

Events, roundtables and seminars for members

ICMA has been far more active in 2010 with events, roundtables and seminars for members – such as the MiFID seminars we ran in various European financial centres, the roundtable on governance with Sir David Walker, various GMRA roundtables, infrastructure seminars, the recent covered bond event organised by our Covered Bond Investor Council in Paris are all examples. In total we held some 60 events in 2010 compared to 40 in 2009. Following our move to 23 College Hill in London we are now able to hold many of the smaller events in-house.

Education

A revitalised education effort has been a priority in 2010. We revised and improved the course structure of ICMA Executive Education, resulting in more than 600 people going through the courses compared to fewer than 400 in 2009. We ran a total of 35 foundation courses, core courses and specialist courses compared with 15 in 2009.

Our education activities will now break even in 2010, which is the desired result and a significant improvement on 2009.

ICMA: 2010 review and 2011 priorities – continued

ICMA regions

The regional structure of ICMA is one of our strengths and continues to flourish – many of the regions are already very active with a thriving local ICMA community. In the last 12 months we have appointed new chairpersons in Germany, UK, Scandinavia, Middle East, France and Latin America and we will continue to provide logistical and financial support to ensure all our ICMA regions are as active as possible and address the specific regional issues members require.

Given the strong interest of our members in developing, we have been strengthening our ties outside Europe. We signed a Memorandum of Understanding with NAFMII, the main SRO in China and also initiated an education venture with the National Development and Reform Commission in China.

In Russia we strengthened our long standing cooperation with the NSMA and set up the "Russia and CIS" ICMA region. We have new members in Brazil and co-operate with Anbima on repo. After a short trip to India to assess the need for our services, we hope to sign a Memorandum of Understanding in early 2011 with an Indian association.

Membership

Membership has been a highlight this year with over 60 financial institutions choosing to join, swelling the ranks of our members to over 400 at the end of 2010 in 50 countries. We are delighted to welcome so many new members, and further details of the members who joined in 2010 can be found on our website.

Financial and operational efficiency

Financial and operational efficiency continued to improve in 2010 – we consistently and systematically coordinate with other relevant associations to avoid duplication, and have ensured that an increasing proportion of our resource is dedicated to serving our members directly. To this end we have hired two further individuals in our regulatory policy and market practice area. Notwithstanding, the cost containment measures we have put in place ensured that the running costs of the Association declined further in 2010.

The challenge remains to provide an increasing level of service whilst ensuring costs are minimised.

Outlook 2011

Looking ahead we see clearly that 2011 will be as busy, if not more so than 2010. We expect the existing workstreams mentioned above to continue throughout 2011, and others to emerge. As a further challenge we remain in the midst of profound change in the international regulatory landscape, and often in the national frameworks as well. For example, the three crucial new supervisory authorities in Europe are in place only from 1 January 2011.

In particular our work on sovereign bonds, on primary processes, on MiFID, repo, infrastructure, liquidity, to name but a few, will be ongoing and heavy.

We will also be continuing to provide relevant and high quality education, and organizing conferences, seminars and roundtables, for our members – and we always welcome ideas on what you would find interesting.

Conclusion

2010 has been a year of intense activity at ICMA and 2011 is shaping up to be even busier. We will remain focused on those areas of the international cross-border securities markets where our work can make a positive contribution to the day-to-day business of our members.

I would like to thank those of our members who actively participate as experts on our many committees and councils – your freely given input and guidance is invaluable, and deeply appreciated.

We look forward to an interesting and active 2011.

Martin Scheck, Chief Executive, ICMA
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Regulation of the international capital markets

The new regulatory framework proposed by the authorities, mainly in response to the crisis, affects our members in the international capital markets – on both the sell side and the buy side – in four main ways: there are changes to prudential regulation; there are changes to market and conduct of business regulation; the perimeter of regulation will be broadened; and new regulatory institutions will be set up to oversee the cross-border securities markets. Our involvement relates to the cross-border securities aspects of these proposals. In addressing them, we cooperate with other trade associations wherever it makes sense to do so for our members. Some of the proposals have been agreed at global level (eg at the G20 Summit in Seoul in November). But for our members in Europe, the legislation that implements global policy agreements, and may supplement them, is largely set at European level: in other words, it is proposed by the European Commission; and agreed with the European Parliament and the Council of Ministers representing the EU Member States. Clearly, it is particularly important that there is coordination between regulators in the EU and regulators in the US and elsewhere in the G20 to avoid regulatory arbitrage.

Prudential regulation

First, the main changes on the prudential side affect capital and liquidity. For banks, the Basel Committee has proposed that there should be an increase in the minimum requirement for capital in the form of common equity from 2% to 4.5% of risk-weighted assets. On top of this, there will be a capital buffer of up to 2.5% to withstand future periods of stress: in other words, 7% in total. As a backstop for these risk-based measures, it is also proposed that there should be a non risk-based leverage ratio, with a minimum Tier 1 ratio of 3% currently being considered. And there are calls for systemically important banks to have loss-absorbing capacity beyond these standards. The new capital rules will be implemented over an extensive transition period so as not to disrupt banks' ability to finance the economic recovery. In the EU, the key legislative provision is the Capital Requirements Directive.

There are two particular aspects of the prudential proposals relating to banks of concern to us at ICMA in the cross-border securities markets. One is liquidity, where we are concerned with the impact, in particular, on the ECP market and the repo market of the proposed revisions to the definition of qualifying liquid assets; the introduction of a liquidity coverage ratio after a transition period; and the possible introduction of a net stable funding ratio in the future (but not yet). The other issue of concern to us is bank resolution (via the use of "bail-ins" under which losses in a failing institution are borne in future by unsecured creditors rather than by taxpayers, as well of course as by shareholders.)

Market and conduct of business regulation

Second, in the case of market and conduct of business regulation, the cross-border securities markets are potentially affected in a number of ways. The European Commission's MiFID review is one of the most important of these. The Commission published in December a consultation paper on its review of MiFID, and is expecting to make a legislative proposal in the spring. The consultation paper takes account of advice from CESR, but in some respects goes beyond it. In particular:

- On non-equity transparency, the Commission consultation paper proposes adopting the broad principles already adopted for the equity regime, but tailoring the non-equity transparency regime to particular markets. It envisages post-trade transparency for all trades, including over-the-counter (OTC) trades, in: all bonds with a prospectus or admitted to trading on a regulated market or multilateral trading facility; and all derivatives eligible for clearing. It envisages new pre-trade transparency obligations for trading on a regulated market or multilateral trading facility, and also for substantial sections of the OTC market. It also proposes imposing on OTC dealers an obligation to make their quotes public and binding up to a specified size.
- On client/counterparty classification, the Commission consultation paper envisages greater constraints on access to professional client or eligible counterparty status.
- The consultation paper focuses on Level 1 legislation, while in some key areas detail will only emerge in Level 2 legislation at a later stage.

Besides the MiFID review, the Commission has also recently proposed a Regulation on Short Selling, which is due to come into effect in July 2012, and is mainly concerned with increasing the transparency of short positions. The aim is to give supervisors the necessary powers to distinguish between legitimate speculation, on the one side, and market abuse, on the other, which they intend to detect and to punish.

Finally, in this area, the Commission has recently proposed a European Market Infrastructure Regulation, which is due to come into effect in 2013. This will require mandatory clearing of all standardised OTC derivatives through central clearing counterparties; and mandatory reporting of all OTC derivatives to trade repositories; common rules for central counterparties and for trade repositories; and more transparency through reporting to trade repositories to help detect any market abuse. Use of central counterparties and trade repositories will increase transparency and eliminate risk between counterparties in the market by netting their exposures. But it will also have the effect of creating new institutions which may be too systemically important to be allowed to fail.

In addition to these proposals on clearing, a proposal for a new Regulation on Settlement and a Directive on Securities Law are expected to follow. The clearing proposals focus at the moment on the derivatives markets, but they may be extended to the cash markets in future, so we need to monitor them carefully.

Broadening the perimeter of regulation

Third, the authorities are also proposing to broaden the perimeter of regulation so that there are no gaps. This involves not just filling in gaps in the regulation of all financial markets and products (like derivatives), but also bringing financial institutions not previously included within the regulatory net:

- First of all, money market funds. A number of separate initiatives act to force money market funds to invest shorter at a time when banks are being encouraged to fund longer.
- There are important regulatory changes so as to include hedge funds, where the Alternative Investment Fund Managers Directive has now been finalised. The Directive will impose capital and disclosure requirements on alternative fund managers on a pan-European basis, prospectively from 2013. There will be a pan-European passport for third country managers after a delay, provided that they and the countries in which they are based meet a number of regulatory conditions. At ICMA, we have supported AIMA's work on the proposed AIFMD.
- And the European Commission is also keen to improve corporate governance, in particular on the buy side. Our Asset Management and Investors Council has responded to the Commission consultation on this, focusing on shareholder engagement and remuneration policy.

New regulatory authorities

Fourth, from the beginning of 2011, three new regulatory authorities at European level have been set up in place of the current committees of national regulators: the European Securities and Markets Authority (ESMA) will oversee the cross-border securities markets on both the sell side and the buy side, taking over from CESR in Paris; and there are separate authorities responsible for banking, and for insurance and pensions. ESMA and the other authorities will have some binding powers to arbitrate in disputes between national regulators and impose common technical rules throughout the European Economic Area. ESMA will also have direct responsibility for authorising – and avoiding over-reliance on – credit rating agencies, and more powers are likely to be given to ESMA under some of the other regulatory proposals currently being negotiated. It is therefore very important for ICMA members that we build on our long-standing relations with CESR to establish good relations with ESMA.

Finally, the European Systemic Risk Board (ESRB) has also been set up from the beginning of 2011 to help detect, prevent and resolve systemic risks. The ESRB is based at the European Central Bank in Frankfurt, and has central bank and regulatory involvement from across Europe. One of the critical issues for the ESRB to consider is whether systemically significant financial institutions should be defined in advance, or whether this would create moral hazard; and whether banks are the only systemically significant institutions, or whether there are circumstances in which insurance companies could be systemically significant as well.

Apart from these institutional changes at European level, our members are also affected by some of the more important institutional changes proposed at national level. For example, the UK Government is proposing to divide up the FSA between a Prudential Regulatory Authority (to become part of the Bank of England) and the Consumer Protection and Markets Authority (CPMA), which will be a separate conduct of business regulator. It was originally proposed in a UK Treasury consultation paper that the UK Listing Authority (UKLA), which is the primary market regulator, should be transferred to a separate UK Government Department. Having consulted our primary market members through our Legal & Documentation Committee, we responded to the Treasury consultation, arguing that it is important to keep the

UKLA in the CPMA, given: the UKLA's international focus; that primary and secondary regulation are closely connected; and that this would more closely mirror the arrangements at ESMA, where the CPMA will represent the UK. Other market participants made similar points. The UK Government has taken account of these points, and agreed that the UKLA should remain in the CPMA.

Setting standards of good market practice within the regulatory framework

Within this new regulatory framework, ICMA has an important role in continuing to set standards of good market practice in three areas:

The first relates to sovereign bonds. During the early stages of the sovereign bond crisis in the euro area in May, it became clear that some investors did not know whether they had bought Greek sovereign bonds issued under Greek law or under foreign law, and they were not clear about the differences between them. Our Chairman encouraged us to set up a Working Group of our members to look at improving the transparency of the terms and conditions for sovereign bond issues and, where possible, improving the terms and conditions themselves. Our Sovereign Bond Consultation Paper was sent to all our members on 23 November and invited their comments on the proposals.

Second, on the corporate bond side, we have been undertaking a "usage review" of the ICMA Primary Market Handbook and the ICMA Rules and Recommendations in the Secondary Market, asking our members to what extent they are used across the market and what improvements can be made.

- On the primary market side, we have also recently incorporated an explanatory note in the ICMA Primary Market Handbook that seeks to provide some practical information on pre-sounding, bookbuilding and the allocation process for new issues. The aim is to enhance transparency and to serve as a point of reference to bookrunners when explaining their working practices to colleagues, issuers and investors.
- On the secondary market side, we have sent an electronic survey to all members on market usage of our Rules and Recommendations in the Secondary Market. We plan to review the results with interested members in our Secondary Market Practices Committee and seek a consensus for making recommendations for improvements.

Third, our Legal Department has been coordinating a review of the 2000 version of the Global Master Repurchase Agreement (GMRA). The GMRA responded well to the international financial crisis. But over the past twelve months, a GMRA Review Working Group – involving market participants and legal experts – has been discussing whether any improvements can be made, as a result of: lessons learned from the crisis; amendments made to other master agreements (such as the GMSLA for securities lending); feedback from GMRA users; and proposals from the European Financial Markets Lawyers Group (EFMLG). The aim is to publish the revised standard in time to incorporate it into the 2011 GMRA legal opinions, which will be made available to ICMA members in the spring of 2011.

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Recent practical initiatives by ICMA

Sovereign bond markets

1. The ICMA Sovereign Bond Consultation Paper recommends improvements in the transparency of the terms and conditions of sovereign bond issues, and asks issuers to disclose whether they meet model concepts of terms and conditions, including collective action clauses. It was sent to members on 23 November for comment.

Short-term markets

2. The ICMA European Repo Council has updated its July White Paper on the *Operation of the European Repo Market, the Role of Short-Selling, the Problem of Settlement Failures and the Need for Reform of the Market Infrastructure*, prepared with the help of Richard Comotto. The new paper sets out the responses to the ERC White Paper from national central securities depositories and central counterparties, and describes the progress that has been made since July towards the elimination of barriers to interconnectivity.

3. The GMRA Review Working Group is nearing the end of the review process. The GMRA 2011 and an associated update protocol will be published alongside the 2011 update of ICMA's GMRA legal opinions in the spring of 2011.

Primary markets

4. In its response to the UK Treasury's consultation on the future of UK financial regulation, the ICMA Legal & Documentation Committee focused on the proposals to transfer the UK Listing Authority (UKLA), the primary market regulator, to a separate Government Department to become a UK company regulator. We argued that it is important to keep the UKLA in the Consumer Protection and Markets Authority (CPMA): to retain the UKLA's international focus; to keep primary and secondary regulation together; and to mirror more closely the responsibilities of the European Securities and Markets Authority (ESMA), where the CPMA will represent the UK. The UK Government has accepted these arguments and decided to keep the UKLA in the CPMA.

5. We have responded to a US Internal Revenue Service consultation on *Information Reporting and Withholding under the Hiring Incentives to Restore Employment Act (HIREA).* This deals with tax implications for global bearer bond issues under US legislation.

6. With our members, we are holding a round of individual meetings with national regulators (starting with the CNMV in Madrid, CSSF in Luxembourg and BaFIN in Frankfurt) on CESR/ESMA's forthcoming work on Level 2 of the review of the Prospectus Directive.

7. Following two Allocation Roundtables involving issuers, lead managers and investors, we have added Explanatory Note XIII on *Pre-sounding, Bookbuilding and Allocations* to the ICMA Primary Market Handbook, and published the Explanatory Note. A further Allocation Roundtable is planned.

8. We held our annual Primary Market Forum at Clifford Chance's offices in Canary Wharf on 30 November.

9. As part of our Usage Review, we have consulted the ICMA Primary Market Practices Committee, the Legal & Documentation Committee and the ECP Committee on their usage of the ICMA Primary Market Handbook. The Review is ongoing.

Secondary markets

10. As part of our Usage Review, we have sent out an electronic survey to all our members on their usage of the ICMA Secondary Market Rules and Recommendations. We have received 150 responses from members, of which 64 member firms have completed the questions in the survey. Of the 64 member firms which completed the survey, 52 state that they always, almost always or usually follow the ICMA Secondary Market Rules

Recent practical initiatives by ICMA – continued

and Recommendations when they buy or sell an international security, and 51 consider that the Rules and Recommendations are always, almost always or usually used across the market as a whole.

11. We plan to review the results of the survey with our Secondary Market Practices Committee and seek a consensus for making recommendations for improvements.

12. We have held a series of well attended seminars for our members on the European Commission's proposed review of MiFID: in Zurich at SIX; in Luxembourg at the EIB; and in Milan at Banca IMI. In response to our invitation, ISDA participated in all three events.

13. We have also held a Roundtable on the MiFID review as the first of a series of monthly roundtables at 23 College Hill for our members in London.

14. We plan to respond to the forthcoming European Commission consultation paper on the MiFID review in consultation both with our own secondary market experts, and we are working closely with other trade associations.

15. We are also currently discussing with other trade associations the market's concerns about Article 13 of the proposed Regulation on Short Selling, which relates to the buy-in of securities.

Asset management

16. The ICMA Asset Management and Investors Council (AMIC), chaired by Bob Parker of Credit Suisse, has set up a Valuation of Illiquid Assets Working Group, supported pro bono by KPMG. With the help of the Working Group, the AMIC has submitted a response to the IOSCO Consultation Paper on *Intermediary Internal Controls Associated with Price Verification of Structured Finance Products and Regulatory Approaches to Liquidity Risk Management.*

17. Following its meeting in October, the AMIC Private Banking Working Group has reached a consensus on the draft text of an ICMA Private Wealth Management Charter of Quality. The next step is to discuss the Charter with large wealth managers not on the Working Group, and to seek their endorsement of it.

18. The ICMA AMIC has responded to the FSA Consultation Paper on *Revising the Remuneration Code.*

19. The ICMA AMIC has had meetings with the FSA and Financial Reporting Council as part of building its relationships with regulators. The Chairman of the Financial Reporting Council spoke at the dinner before the AMIC meeting in London on 14 December.

20. The ICMA Covered Bond Investor Council organised a Roundtable for Covered Bond Investors in Paris on 8 December.

Market infrastructure

21. We arranged a Roundtable to brief ICMA members on the European Commission's proposed European Market Infrastructure Regulation (EMIR), introduced by Godfried De Vidts of ICAP, Chair of our European Repo Committee. EMIR particularly covers OTC derivatives, central counterparties and trade repositories, but its scope is wide and has implications across securities markets.

22. The AMTE Council's Electronic Trade Confirmation Working Group, chaired by Patrice Brault of Tradition, proposed a recommendation on electronic trade confirmations, which became effective on 1 January.

23. Negotiations with Euroclear and Clearstream (the ICSDs) have continued on their plans to encourage straight-through-processing by inviting issuers to sign a letter of representation linked to an ICSD market practice book.

G20 financial regulatory reforms

The European Council met in Brussels on 16 September. The published conclusions particularly included the following paragraph:

"The G20 Summit in Seoul will allow a review of the global economic recovery and the commitments made by G20 members. In particular, it will allow the Union to stress the importance of maintaining strong momentum in the area of financial reform; in this respect, the recent agreement between the European Parliament and the Council on the financial supervision package and the completion of the reform of the regulatory framework by the end of 2011 strengthen the EU's hand. It should also serve to send a clear signal on the need to conclude the WTO DDA negotiations and implement the *Framework for Strong, Sustainable and Balanced Growth.* The European Council will discuss the detailed preparation of Seoul at its October 2010 meeting and set the Union's position. The G8 and the G20 will remain important fora for the definition of global responses to many of the challenges facing us, to which the EU must actively contribute through coordinated positions. The European Council therefore welcomes the ambition of the incoming French chairmanship in 2011 to fully use the G20 and G8 to that end."

On 27 September, the Financial Stability Board (FSB) met in Paris. It reviewed risks and vulnerabilities affecting the global financial system and progress on the regulatory reform agenda under coordination by the FSB.

In early October, the European Commission published an update note to the ECOFIN and some associated information – *G20 Roadmap: Where We Have Got To.* This note, which is provided for general discussion and information purposes, outlines some of the main features of the US reform and reviews some important developments in other G20 countries (it should be read in conjunction with the implementation table on Brazil, China, Japan, India and Russia; and the table with the comparison between the EU and the US).

Dated 10 October, the G30 issued a press release, regarding the launch of its new report – *Enhancing Financial Stability and Resilience: Macro-prudential Policy, Tools and Systems for the Future* – which aimed to build political support for macro-prudential initiatives ahead of the G20 Summit in Seoul. The report defines the concept of macro-prudential policy, identifies tools and institutional structures that can be used for its implementation, and offers recommendations for the policymaking community on enhancing the stability of the financial system. The authors also propose that public officials empower systemic financial regulators with new tools to enhance economic stability and potentially lessen the severity of any future economic crises.

In preparation for the G20 Leaders Summit meeting in Seoul, South Korea, on 11-12 November, a G20 Finance Ministers and Central Bank Governors meeting took place on 23 October – from which a closing Communiqué was published. This includes a commitment to "complete financial repair and regulatory reforms without delay" and, *inter alia,* goes on to say:

"We have made significant strides since the adoption of the Action Plan to Implement Principles for Reform at the Washington Summit in November 2008, with support from the FSB. We are committed to take action at the national and international level to raise standards, so that our national authorities implement global standards consistently, in a way that ensures a level playing field and avoids fragmentation of markets, protectionism and regulatory arbitrage. To build a stronger global financial system, we have agreed to prioritize the following issues on the agenda for the Seoul Summit:

- Welcome and commit to fully implement within the agreed timeframe the new bank capital and liquidity framework drawn up by the Basel Committee and the Governors and Heads of Supervision.
- Endorsement of the FSB's recommendations to increase supervisory intensity and effectiveness.
- Endorsement of the policy framework, work processes and timelines proposed by the FSB to mitigate the risks posed by Systemically Important Financial Institutions and address the "too-big-to-fail" problems.
- Commitment to implement all aspects of the G20 financial regulation agenda, in an internationally consistent and non-discriminatory manner, including the commitments on OTC derivatives, compensation practices and accounting standards and FSB principles on reducing reliance on credit rating agencies.
- Further work on macro-prudential policy frameworks, including tools to help mitigate the impact of excessive capital flows; the reflection of the perspective of emerging market economies in financial regulatory reforms, including through increased outreach; commodity derivative markets; shadow banking; and market integrity.
- Pursue our work decisively to tackle Non-Cooperative Jurisdictions."

Following from its meeting in Brussels, the conclusions of the 28-29 October European Council meeting were published. With respect to the Seoul G20 Summit they report, *inter alia,* that:

"The European Union looks forward to the confirmation by the G20 Summit of the Basel agreement, which is an important step in strengthening global financial stability. The European Union emphasises the need to continue keeping markets open, to inject momentum into the Doha negotiations and to adopt a growth oriented development agenda. It stresses the need to avoid all forms of protectionism and to avoid engaging in exchange-rate moves aimed at gaining short-term competitive advantages."

Following from the Leaders' meeting in Seoul, South Korea, on 11-12 November, the G20 Seoul Summit outcome documents were published. With respect to financial regulation, the Leaders Declaration says:

"9. Today, the Seoul Summit delivers: …. the core elements of a new financial regulatory framework, including bank capital and liquidity standards, as well as measures to better regulate and effectively resolve systemically important financial institutions, complemented by more effective oversight and supervision. This new framework, complemented by other achievements as outlined in the Seoul Summit Document, will ensure a more resilient financial system by reining in the past excesses of the financial sector and better serving the needs of our economies…."; and

"11. Building on our achievements to date, we have agreed to work further on macro-prudential policy frameworks; better reflect the perspective of emerging market economies in financial regulatory reforms; strengthen regulation and oversight of shadow banking; further work on regulation and supervision of commodity derivatives markets; improve market integrity and efficiency; enhance consumer protection; pursue all outstanding governance reform issues at the IMF and World Bank; and build a more stable and resilient international monetary system, including by further strengthening global financial safety nets. We will also expand our MAP based on the indicative guidelines to be agreed."

The Seoul Summit Document says:

"9. Financial Reforms: We are committed to take action at the national and international level to raise standards, and ensure that our national authorities implement global standards developed to date, consistently, in a way that ensures a level playing field, a race to the top and avoids fragmentation of markets, protectionism and regulatory arbitrage. In particular, we will implement fully the new bank capital and liquidity standards and address too-big-to-fail problems. We agreed to further work on financial regulatory reforms."

Paragraphs 27-41 then spell out more details on "Financial Sector Reforms", including points relating to "Transformed financial system to address the root causes of the crisis"; "Implementation and international assessment, including peer review"; and "Future work: Issues that warrant more attention".

The supporting document provides a table which, for each country, includes a section on "financial sector policy". There is also a short press release concerning "G20 Plenary Session IV: Financial Regulatory Reform".

The FSB has issued a press release, regarding its input to the G20. This provides links to:

- a letter from the FSB Chairman to the G20 Leaders, describing "Progress of Financial Regulatory Reforms";
- the policy framework for reducing the moral hazard posed by systemically important financial institutions (SIFIs) (see also separate press release); and
- a report on progress in the implementation of the G20 recommendations for strengthening financial stability.

The FSB Chairman's letter includes sections on "Bank capital and liquidity standards"; "Addressing the moral hazard risk associated with SIFIs"; "Supervisory intensity and effectiveness"; "OTC derivatives reforms"; "Principles for reducing reliance on CRA ratings"; and "Reform programme going forward".

The G20 Leaders at the Seoul Summit on 11-12 November endorsed the FSB's policy framework for reducing the moral hazard of SIFIs, including the work processes and timelines set out in the report submitted to the Summit. The framework calls for action in five areas:

- first, and foremost, improvements to resolution regimes to ensure that any financial institutions can be resolved without disruptions to the financial system and without taxpayer support;
- second, a requirement that SIFIs and initially in particular global SIFIs (G-SIFIs) have additional loss absorption capacity beyond the Basel III standards to reflect the greater risks that these institutions pose to the global financial system;
- third, more intensive supervisory oversight for financial institutions which may pose systemic risk;
- fourth, stronger robustness standards for core financial infrastructure to reduce contagion risks from the failure of individual institutions; and

- fifth, peer review by an FSB Peer Review Council of the effectiveness and consistency of national policy measures for G-SIFIs, beginning by end-2012.

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European reform of financial supervision

Further to the ECOFIN's 7 September endorsement of the proposed new EU framework for financial supervision, on 22 September the European Parliament gave its affirmative plenary vote. The results of the votes were overwhelming majorities. The existing three Level 3 Committees (3L3), CESR, CEBS and CEIOPS, welcomed this agreement.

Subsequently the 17 November ECOFIN Council meeting conclusions were reported in a press release. Included in the main results are that the Council (as anticipated) adopted legal texts establishing the European Systemic Risk Board (ESRB) and the three new European Supervisory Authorities (ESAs); affirming that the new EU financial supervisory system will be operational as from 1 January 2011 (the texts were published in the *Official Journal* on 15 December). The four new bodies are part of a European System of Financial Supervisors (ESFS), which includes the supervisory authorities of the Member States. The ESRB and the European Insurance and Occupational Pensions Authority (EIOPA) are sited in Frankfurt, the European Banking Authority (EBA) in London and the European Securities and Markets Authority (ESMA) in Paris.

Also included in the package adopted were:

- a Decision entrusting the European Central Bank with specific tasks with regard to the day-to-day running of the ESRB; and
- a Directive amending Directives 98/26/EC, 2002/87/EC, 2003/6/EC, 2003/41/EC, 2003/71/EC, 2004/39/EC, 2004/109/EC, 2005/60/EC, 2006/48/EC, 2006/49/EC and 2009/65/EC in respect of the powers conferred on the three European authorities – the, so-called, "Omnibus" Directive.
- The Authorities are already looking for the new staff to fill vacancies.

Dated 26 November, CESR issued a call for expressions of interest regarding the setting up of ESMA's Securities and Markets Stakeholder Group – applications for appointment to the Group had to be submitted by no later than 23 December. Members of the Group, 30 in total, will be appointed to represent different stakeholders in balanced proportions. The group will meet at least 4 times a year, and is expected to meet in the Authority's premises in Paris.

According to the Regulation, the main tasks of the Group are:

- to advise the Authority on actions taken in accordance with the Regulation concerning regulatory technical standards and implementing technical standards;
- to advise the Authority on actions taken in accordance with the Regulation concerning guidelines and recommendations, to the extent that these do not concern individual financial institutions; and
- to advise and assist the Authority in assessing the potential impact of the proposed draft regulatory and implementing technical standards, guidelines and recommendations, to the extent that these do not concern individual financial institutions.

The Group may submit opinions and advice on any issue related to the tasks of the Authority with particular focus on the areas listed above and on the following ones, thus:

- requesting, as appropriate, the Authority to investigate the alleged breach or non-application of Union law;
- contributing to the Authorities' efforts to establish a European common supervisory culture and consistent supervisory practices;
- advising the Authority on its peer review activity; and
- contributing to the Authority's assessment of market developments.

Similar calls have been issued for groups being established by the CEBS and by the CEIOPS.

On 8 December, the European Commission adopted a Communication setting out possible ways to reinforce sanctioning regimes in the EU's financial services sector. Today, rules vary greatly between Member States and, arguably, often do not serve as an effective deterrent. Based on a review of national sanctioning regimes for violations of national rules transposing some of the most important EU directives relating to financial services, the Communication presents areas for improvement and suggests possible

EU actions in order to achieve greater convergence and efficiency of these regimes. Contributions from interested stakeholders are requested up until 19 February. On the basis of the comments received, the Commission will decide during 2011 on possible proposals on how to reinforce sanctioning regimes.

Strengthening sanctioning regimes is one of the elements of the financial sector reform. It complements other strands of work already being phased in or of a more "preventative" nature, including effective supervision and corporate governance. Efficient and sufficiently convergent sanctioning regimes are the necessary corollary to the new ESAs, set up on 1 January 2011, and will bring about improvements in the coordination of national authorities' enforcement activities. The issue of more effective sanctions is also agreed at global level. The action plan for reform of financial markets, agreed by G20 leaders in the November 2008 Washington Summit, included actions aimed at protecting markets and investors against illicit conduct and ensuring that appropriate sanctioning regimes are in place.

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OTC (derivatives) regulatory developments

On 15 September, the Commission adopted a Regulation on OTC derivatives, central counterparties and trade repositories. The Regulation introduces a reporting obligation for over-the-counter (OTC) derivatives; a clearing obligation for eligible OTC derivatives; measures to reduce counterparty credit risk and operational risk for bilaterally cleared OTC derivatives; common rules for central counterparties (CCPs) and for trade repositories; and rules on the establishment of interoperability between CCPs. This initiative is discussed in greater detail in the section of this Newsletter relating to the repo market.

In a 15 October media release the International Organization of Securities Commissions (IOSCO) announced that it has formed a Task Force on OTC Derivatives Regulation. This Task Force has been established to coordinate securities and futures regulators' efforts to work together in the development of supervisory and oversight structures related to OTC derivatives markets. The Task Force will produce the following work on a phased basis in the following sequence: a report on exchange and electronic trading; a report on data reporting and aggregation requirements; and a report on international standards. The Task Force will be led by the US SEC, the US CFTC, the UK FSA and the Securities and Exchange Board of India.

Under cover of its 25 October press release the FSB released its report on *Implementing OTC Derivatives Market Reforms,* which sets out common approaches to implementing reforms to OTC derivatives markets in an internationally consistent and non-discriminatory way. The report sets out 21 recommendations addressing implementation of the G20 commitments concerning standardisation, central clearing, organised platform trading, and reporting to trade repositories:

- *Standardisation:* The proportion of the market that is standardised should be substantially increased. Authorities should work with market participants to increase standardisation, including through introducing incentives and, where appropriate, regulation.
- *Central clearing:* All standardised derivatives should be centrally cleared in order to mitigate systemic risk. The report sets out the factors that should be taken into account when determining whether a derivative contract is standardised and should be centrally cleared. The recommendations also address mandatory clearing requirements; robust risk management requirements for the remaining non-centrally cleared markets; and supervision, oversight and regulation of CCPs.
- *Exchange or electronic platform trading:* IOSCO will complete an analysis by end-January 2011 identifying the actions that may be needed to fully achieve the G20 commitment that all standardised products be traded on exchanges or electronic trading platforms, where appropriate.
- *Reporting to trade repositories:* Authorities must have a global view of the OTC derivatives markets, through full and timely access to the data needed to carry out their respective mandates. All OTC derivatives transactions must be reported to trade repositories. Trade repository data must be comprehensive, uniform and reliable and, if from more than one source, provided in a form that facilitates aggregation on a global scale.

This report is only the first step toward consistent implementation of the G20 commitments, and highlights the amount of work that remains going forward. The Working

Group will make regular reports on progress in implementing the necessary reforms to the FSB, with the first report to be given in March 2011.

The Federal Reserve Bank of New York hosted a meeting of the OTC Derivatives Regulators' Forum (ODRF) — a group comprised of over 50 financial regulators from around the world — on 2 and 3 November. The group reaffirmed continued coordination on matters relating to centralised market infrastructure serving the global OTC derivatives markets — CCPs and trade repositories (TRs) — and discussed its work in light of recent global regulatory developments. The group also met with representatives from OTC derivatives CCPs and TRs to discuss current market developments and ongoing engagement.

In a report published on 10 November by the Committee on Payment and Settlement Systems (CPSS), central bankers examine developments in the clearing industry's market structure, their drivers and the implications for financial stability. The report, *Market Structure Developments in the Clearing Industry: Implications for Financial Stability,* first provides a broad overview of the clearing industry in CPSS countries, covering both traditional markets and OTC derivatives markets. Second, the report assesses how far these developments have given rise to new risks. Furthermore, the report examines to what extent changes in market structure or ownership might affect the expansion of central clearing services. Finally, the effect of ownership on CCPs' incentives to manage counterparty risk is considered.

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Capital requirements

As reported in the Fourth Quarter Newsletter, in the 26 July press release from the Bank for International Settlements (BIS), the Group of Governors and Heads of Supervision (GHoS) announced that they had reached broad agreement on the Basel Committee of Banking Supervision (BCBS) capital and liquidity reform package. Dated 12 September, there was a further press release from the BIS, in which the GHoS announced a substantial strengthening of existing capital requirements and fully endorsed the agreements reached on 26 July.

On 19 October, the Basel Committee on Banking Supervision (BCBS) met in Seoul to work towards finalising its reform programme. The Committee agreed on key details of the liquidity coverage ratio. It also reviewed public comments received on its August proposal to ensure the loss absorbency of regulatory capital at the point of non-viability and agreed to finalise the proposal by year end. Finally, the Committee agreed to release its report on calibrating regulatory minimum capital requirements and capital buffers – a top-down approach. At the conclusion of the meeting, the Basel Committee also released a *Report to the G20 on Response to the Financial Crisis.*

On 20 October, the Financial Stability Board also met in Seoul. The meeting welcomed the BCBS's global bank capital and liquidity standards; agreed on a framework for addressing systemically important financial institutions; endorsed recommendations for increasing the intensity and effectiveness of financial supervision; approved recommendations for implementing central clearing and trade reporting of over-the-counter (OTC) derivatives; and endorsed principles for reducing reliance on credit rating agency ratings. The meeting also reviewed progress on other elements of the financial regulatory reform agenda, including accounting convergence, established FSB regional outreach arrangements, and discussed the future work programme.

On 3 November, the IMF published a new staff position note entitled *Impact of Regulatory Reforms on Large and Complex Financial Institutions* (LCFIs). The scope of the analysis for this paper is to explore the overall impact of the new BCBS capital standards for a representative group of 62 LCFIs. In brief, the "Summary and Policy Implications" section of this paper states:

- The current BCBS proposals on capital requirements represent a substantial improvement in the quality, quantity, and comparability of bank capital; and that most banks can meet the more stringent capital requirements through earnings retention, provided a modest earnings outlook.
- Going forward, some banks may face challenges in meeting the liquidity requirements in the current global environment.
- A key challenge for policymakers is to ensure that potential adjustments in business strategies to tighter capital and liquidity requirements do not generate systemic risks.

- These factors argue for a number of safeguards to ensure that recent reforms are consistent with the objective of mitigating systemic risk:
    - There is a continuing need for policymakers to restructure or resolve weak banks.
    - Supervision needs to be more intensive to prevent a new cycle of leveraging and excessive risk taking.
    - The regulatory perimeter needs to be widened.
    - The need for coordination of policies, as well as of their implementation, is greater than ever.
    - Finally, agreement on cross-border resolution regimes should be a top priority.

At its meeting on 30 November and 1 December, the BCBS agreed on the details of the Basel III rules text, which includes global regulatory standards on capital adequacy and liquidity. In addition, the BCBS reviewed issues related to globally systemic banking institutions. Such banks should have loss-absorbing capacity beyond the Basel III standards and work on this topic continues in the BCBS and the FSB. The BCBS reviewed a provisional methodology comprising both quantitative and qualitative indicators to assist national authorities in assessing the systemic importance of financial institutions at the global level. It was due to send a paper on these topics to the FSB by the end of 2010 for its review. Taking account of comments received during a recent public consultation, the Committee agreed on key elements of the proposal to ensure the loss absorbency of regulatory capital at the point of non-viability and will elaborate the rules concerning transitional arrangements and grandfathering.

The Committee also discussed cross-border banking resolution. It agreed to undertake further work to evaluate progress in national and multinational efforts to adopt improvements that enhance authorities' capability to manage and resolve distressed banking institutions in a manner that minimises disruptions to the financial system.

On 16 December, the BCBS issued the Basel III rules text, which presents the details of global regulatory standards on bank capital adequacy and liquidity agreed by the GHoS, and endorsed by the G20 Leaders at their November Seoul summit. This is discussed in some further detail in the short-term markets section of this Newsletter. The BCBS also published its guidance for national authorities operating the countercyclical capital buffer and the results of its comprehensive quantitative impact study (QIS); and CEBS published the results of its comprehensive QIS analysing the impact of Basel III requirements on the European banking industry.

This was followed on 20 December by the BCBS issuing a consultative paper on the capitalisation of bank exposures to central counterparties. These proposals relate to the capitalisation of bank exposures to a central counterparty (CCP) and, in particular, default fund exposures. Generally speaking, the Committee proposes that trade exposures to a qualifying CCP will receive a 2% risk weight. This is further discussed in the repo market section of this Newsletter. In addition, default fund exposures to a CCP will, in accordance with a risk sensitive waterfall approach (based on a CCP's actual financial resources and hypothetical capital requirements), be capitalised according to a method that consistently and simply estimates risk arising from such default fund.

Broadly in parallel with all of this, the European Commission is continuing its work on further possible changes to the Capital Requirements Directive (CRD). On 22 October, it launched a public consultation to seek stakeholders' views on possible measures to ease fluctuations in the financial system by introducing countercyclical capital buffers for banks (ie variable capital reserves that banks would have to accumulate during economically good times and draw upon to continue lending economic conditions worsen). These reserves would be added to banks' minimum regulatory capital and the capital conservation buffer. In the light of the feedback received from this consultation (deadline 19 November), the Commission is further considering whether capital buffers should be introduced in the EU through the upcoming amendment to the Capital Requirements Directive – now expected to be proposed in the second quarter of 2011.

Separately, the European Council has adopted the CRD 3 legislative package covering remuneration, higher capital charges for the trading book and re-securitisations. The finalised rules are to take effect as from January 2011 for the bonus provisions and as of year-end 2011 for the capital requirements provisions.

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Credit rating agencies

The EU's Credit Rating Agencies (CRAs) Regulation entered into force on 7 December 2009. EU authorised financial institutions should note that consequently their use of credit ratings in accordance with Article 4(1) is constrained as from 7 December 2010 (as per Article 41 – Entry into force). Nevertheless, in accordance with the transitional provision stated in Article 40, "Existing credit rating agencies may continue issuing credit ratings which may be used for regulatory purposes by the financial institutions referred to in Article 4(1) unless registration is refused." Additionally, question 14 of the FAQ issued by CESR on 4 June clarifies that "Ratings from third countries that a CRA intends to endorse (as disclosed in its application) will be allowed to be used for regulatory purposes until the registration decision with regard to the endorsing CRA is made."

On 28 September, the European Commission delivered its opinion on the recognition of the legal and supervisory framework of Japan as equivalent to the requirements of Regulation. This states that "…the Japanese legal and supervisory framework for credit rating agencies shall be considered as equivalent…". Thus far, this is the only such equivalence ruling that the Commission has published.

Dated 6 December, CESR published its first annual report on the application of the CRA Regulation, in accordance with Article 21(4). At the time of the publication of this report only one credit rating agency (Euler Hermes Rating GmbH) had been registered, while assessment of the other 23 applications received by CESR between 7 June and 7 September was proceeding within the colleges of supervisors or the individual home competent authorities. As the registration process was still pending for the large majority of the applications submitted by credit rating agencies, the report could only provide a high level description of the status of the application of the CRA Regulation.

Dated 2 June, the Commission proposed improved EU supervision of CRAs. Under the proposed changes, the new European supervisory authority – the European Securities and Markets Authority (ESMA) – would be entrusted with exclusive supervision powers over CRAs registered in the EU. This would include also the European subsidiaries of well-known CRAs such as Fitch, Moody's and Standard & Poor's. As announced on 15 December, a version of these latest amendments to the rules regulating CRAs was approved by the European Parliament (EP). The Council has also indicated its conditional approval. The new rules are to come into force by 1 July.

Under cover of its 27 October press release, the FSB released its *Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings,* the goal of which is to reduce mechanistic reliance on ratings and to incentivise improvements in independent credit risk assessment and due diligence capacity.

The principles aim to catalyse a significant change in existing practices. They cover the application of the broad objectives in five areas:

- prudential supervision of banks;
- policies of investment managers and institutional investors;
- central bank operations;
- private sector margin requirements; and
- disclosure requirements for issuers of securities.

The FSB has asked standard setters and regulators to consider the next steps that could be taken to translate the principles into more specific policy actions to reduce reliance on CRA ratings in laws and regulations, whilst recognising that changes in market practices cannot happen overnight. The FSB will report to G20 Finance Ministers and Governors on progress during 2011.

On 5 November, the European Commission launched a new consultation regarding CRAs. There are growing concerns that financial institutions and institutional investors may be relying too much on external ratings and do not carry out sufficient internal credit risk assessments, which may lead to volatile markets and instability of the financial system. The purpose of this consultation is to open a wider debate and get input from all stakeholders in order to calibrate the scope and ambition of any possible future legislative initiative in the field of credit rating agencies. These issues are similar to those raised at a global level in the recent FSB report. The deadline for replies was 7 January 2011. (See the asset management section of this Newsletter.)

In relation to this new Commission consultation, there is a 24 November draft report on *Credit Rating Agencies: Future Perspectives,* from the EP's rapporteur, Wolf Klinz. This stresses "that it is important to bear in mind that the potential measures to be taken should undergo the necessary impact assessments and scrutiny". The report looks at the matter using a top-down approach, firstly assessing the macroeconomic role of CRAs in the global financial market regulation and then looking at the intermediate level and questions of competition and the industry structure, before finally assessing conflicts of interest in the business model, ie the micro level. ECON's 13 December agenda included consideration of this draft report.

Dated 30 November, the Committee of European Banking Supervisors (CEBS) published its revised Guidelines on the recognition of External Credit Assessment Institutions (ECAIs), which were first released on 20 January 2006. To ensure consistency between the CRA Regulation and the Capital Requirements Directive (CRD), Articles 81(2) and 97(2) of the CRD have been amended to avoid duplication of work and to reduce the burden of the recognition process where an ECAI is registered as a CRA at Community level. These amendments will have to be applied from 31 December 2010. In addition, drawing on the experience of CEBS members in the application of the guidelines, CEBS has taken this opportunity to review its common understanding of the technical criteria set out in Part 2 of Annex VI of the CRD, and has slightly amended its understanding of the requirements on "Credibility and Market Acceptance" and "Transparency and Disclosure"' with respect to the individual credit assessments. Also on 13 October, CEBS published its consultation paper on its draft advice to the European Commission on the non-eligibility of entities producing only credit scores for ECAI recognition. Subsequently, on 17 December CEBS published its advice to the European Commission and a related feedback statement.

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Crisis management-related measures

In its 20 October press release, the Commission sets out its plans for a new EU framework for crisis management in the financial sector. These pave the way for legislation due by spring 2011 which will create a comprehensive crisis management framework for banks and investment firms.

The new framework described in the Communication will be broad-ranging and aims to equip authorities with common and effective tools and powers to tackle bank crises at the earliest possible moment, and avoid costs for taxpayers. The toolbox of measures will include:

- preparatory and preventative measures such as a requirement for institutions and authorities to prepare for recovery (ie dealing with serious difficulties faced by a bank) and resolution plans to ensure adequate planning for financial stress or failure (such plans are called "living wills");
- powers to take early action to remedy problems before they become severe such as powers for supervisors to require the replacement of management, or to require an institution to implement a recovery plan or to divest itself of activities or business lines that pose an excessive risk to its financial soundness;
- resolution tools, such as powers to effect the takeover of a failing bank or firm by a sound institution, or to transfer all or part of its business to a temporary bridge bank, which would enable authorities to ensure the continuity of essential services and to manage the failure in an orderly way.

No entity should be "too big to fail". The overriding objective will be to ensure that banks can fail without jeopardising wider financial stability. That means banks can be resolved in ways which minimise the risks of contagion and ensure continuity of essential financial services, including continuous access for bank account holders to their accounts. The framework is intended to provide a credible alternative to the expensive bank bail-outs we have seen in the last couple of years.

The Commission proposes to build on existing supervisory colleges (groups of national supervisors) to set up resolution colleges (where supervisors and national authorities in charge of resolution would meet), for the purposes of crisis preparation and management – with specific roles for the new ESAs (in particular the EBA).

With respect to crisis management the ECOFIN published *Conclusions on Crisis Prevention, Management and Resolution,* as agreed on 7 December: "The Council underlines, in particular, that an EU framework for crisis prevention, management and resolution should aim at preserving financial stability by protecting public and market confidence; putting prevention and preparation first; providing credible resolution tools; enabling fast and decisive action; reducing moral hazard and minimising to the fullest possible extent the overall costs to public funds, by ensuring fair burden sharing among the financial institutions' stakeholders; contributing to a smooth resolution of cross border groups; ensuring legal certainty; and, limiting distortions of competition."

"The Council stresses the importance of making progress in respect of the work strands set out in the Commission Communication…" and "welcomes the broad thrust of the programme presented therein by the Commission". The Council's adopted conclusions include points on:

- the scope and fair burden-sharing objective presented by the Commission for its forthcoming legislative work;
- the principal elements of the future regulatory framework;
- preparatory and preventative measures;
- early intervention;
- resolution; and
- financing resolution in the medium term.

In an annex to the conclusions there is an ECOFIN roadmap on an EU-wide framework for crisis prevention, management and resolution (the crisis PMR framework). This includes actions in both the short to medium term (2010-2012) and the medium to longer term (2012-2014).

On 6 January the European Commission launched a consultation on technical details underpinning the European Crisis Management framework to be read in conjunction with the communication of 20 October . The Commission intends to come forward with a legislative proposal for a comprehensive framework for dealing with failing banks before the Summer of 2011. The deadline for contributions to this consultation is 3 March 2011.

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IOSCO update of its *Principles of Securities Regulation*

Richard Britton

For the last year ICMA and the majority of its membership have been focusing, rightly, on the prospects of major regulatory change in Europe while keeping the situation in the US, post the Dodd Frank Act, under close scrutiny. At a global level securities market regulators have also been re-evaluating the standards by which they should judge themselves and be assessed by the International Financial Institutions, the IMF and the World Bank. The International Organization of Securities Commissions (IOSCO) recently published extensive amendments to its *Objectives and Principles of Securities Regulation.* First drawn up in 1998 the IOSCO Principles are one of twelve standards and codes (including those on clearing and settlement) highlighted by the Financial Stability Board as key to sound financial systems and deserving priority implementation. In particular they stand alongside the *Basel Core Principles for Effective Banking Supervision.* IOSCO, as the international standard setter for securities regulation, is the expert body responsible for interpretation of the Principles. In 2003 it developed a Methodology for assessing compliance with the Principles based on a series of "key questions" focused on the necessary detailed components of an effective and robust regulatory regime. In addition to so called "self assessments" by regulators, the IMF and World Bank have carried out independent assessments in more than 70 jurisdictions including most of Europe, Canada, US, Brazil, India, Japan and China. Their conclusions can be found on their websites. The G20 has stated that, in future, it expects its members to submit to this process every five years. The Principles and Methodology serve several purposes. Particularly (but not only) for regulators in emerging markets they set out a check list of necessary laws, rules and regulations; for all regulators they provide benchmarks against which to assess the effectiveness of their regulatory and enforcement activities.

For example, Principle 17 requires that holders of securities in a company should be treated in a fair and equitable manner while Principle 12 requires that the regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers. These are matters of judgement, always difficult and sometimes controversial. But in its recent consultation on revising the Market Abuse Directive the Commission's comment on the weakness of sanctions in some Member States, based on evidence provided by CESR, indicates that it believes they would have difficulty passing the Principle 12 test.

In June 2010, IOSCO published eight new Principles which largely reflect recent events. They cover specific policy areas such as hedge funds, credit rating agencies and auditor independence and oversight; broader areas include monitoring, mitigating and managing systemic risk; regularly reviewing the perimeter of regulation (what should be in and what can be outside); and requiring that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed. Currently IOSCO is redrafting the Methodology to cover the new Principles and to improve the benchmarking of the thirty original Principles. The goal is to complete the process in time for approval by the 120 statutory regulators that are members of IOSCO at its AGM in April 2011.

Despite criticism in some quarters over the last three years, self regulation retains its important role within the Principles. IOSCO continues to state that there can be substantial benefits from self regulation, whereby SROs may require the observance of ethical standards which go beyond government regulations. It also recognises that SROs may offer considerable depth and expertise regarding market operations and practices, and may be able to respond more quickly and flexibly than government authorities to changing market conditions. ICMA, as a member of the SRO Consultative Committee of IOSCO, is currently contributing to the ongoing evolution of the relationship between self and statutory regulators and will continue to stress the benefits self regulation can bring to fair, efficient and orderly markets.

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Euro Commercial Paper market

Liquidity regulation: As reported in the Fourth Quarter Newsletter, in the 26 July press release from the BIS, the Group of Governors and Heads of Supervision (GHoS) announced that they had reached broad agreement on the Basel Committee of Banking Supervision (BCBS) capital and liquidity reform package. Dated 12 September, there was a further press release from the BIS, in which the GHoS announced a substantial strengthening of existing capital requirements and fully endorsed the agreements reached on 26 July.

At its meeting on 30 November and 1 December, the BCBS agreed on the details of the Basel III rules text, which includes global regulatory standards on capital adequacy and liquidity. Then on 16 December the BCBS issued the Basel III rules text, which presents the details of global regulatory standards on bank capital adequacy and liquidity agreed by the GHoS, and endorsed by the G20 Leaders at their November Seoul Summit. The BCBS also published the results of its comprehensive quantitative impact study (QIS). The rules text presents the details of the Basel III Framework, which covers both micro-prudential and macro-prudential elements. The Framework sets out higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the build up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards.

Concerning transition and implementation, the BCBS has put in place processes to ensure the rigorous and consistent global implementation of the Basel III Framework. The standards will be phased in gradually so that the banking sector can move to the higher capital and liquidity standards while supporting lending to the economy. Both the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) will be subject to an observation period and will include a review clause to address any unintended consequences.

Concerning the UK FSA's announced enhanced liquidity regime, its calibration statement of 8 March included a commitment to a further announcement in the fourth quarter of 2010. Accordingly on 18 November the FSA issued a "liquidity calibration statement", indicating that "the FSA does not believe it is appropriate to set industry-wide transition requirements for the UK's larger banks at this stage".

Another liquidity-related point is the 27 October CEBS publication of its *Guidelines on Liquidity Cost Benefit Allocation.* This follows from a consultation exercise conducted in the summer. The principal objective of these CEBS' guidelines is to provide high-level guidance on the main elements to be considered when creating or reviewing adequate fund allocation mechanisms including liquidity cost, benefits and risks. A liquidity cost concept that includes not only direct funding costs, but also associated indirect costs such as liquidity contingency support, is proposed.

Central bank developments: In its 9 October press release, the European Central Bank (ECB) summarises its *New Provisions for the Framework for Implementation of Monetary Policy in the Euro Area.* This links to Guideline ECB/2010/13, amending Guideline ECB/2000/7 on monetary policy instruments and procedures of the Eurosystem. Inter alia, this formally picks up applicable changes discussed in the ECB's 6 August note of other decisions taken by the Governing Council of the ECB. This included amendments to the risk control measures for assets eligible for use as collateral in Eurosystem credit operations and changes relating to the Short-Term European Paper (STEP) market convention.

Dated 15 November, the Bank of England has announced changes to its Asset Purchase Facility. Of particular note are the following two paragraphs of this announcement:

- "First, the Bank is today providing 12 months' notice of its intention to withdraw the Commercial Paper Facility, consistent with the Market Notice issued following the announcement of the Facility in February 2009. The Commercial Paper Facility was designed to act as a backstop to help improve financing conditions for companies. The Bank's intention was that the Facility would only remain operational for as long as the highly abnormal conditions in corporate credit markets that were impairing finance of real economic activity persisted. The Bank's purchases of Commercial Paper have reduced in recent months and there is currently no outstanding stock held."; and
- "Fourth, the Bank has recognised the eligibility of a programme for its Secured Commercial Paper Facility and expects to make purchases shortly. The Secured Commercial Paper Facility was announced in July 2009. It enables the Bank to purchase high quality sterling commercial paper securities that support the financing of working capital. Its aim is to channel funds to a broad range of corporates, including to smaller companies and/or companies of below investment grade credit-quality."

Money market funds (MMFs) are key investors for ECP, so the ICMA ECP Committee continues to review various official changes directly impacting such funds.

Under cover of a 21 October press release, the President's Working Group (PWG) on Financial Markets released its long-awaited study of possible further reforms. This report, which was published over a year later than anticipated, does not opine on recommendations for reform of the structure of the US money funds industry, but rather lays out 8 options:

- floating net asset values;
- private emergency liquidity facilities for MMFs;
- mandatory redemptions in kind;
- insurance for MMFs;
- a two-tier system of MMFs with enhanced protections for stable NAV funds;
- a two-tier system of MMFs with stable NAV MMFs reserved for retail investors;
- regulating stable NAV MMFs as special purpose banks; and
- enhanced constraints on unregulated MMF substitutes.

Dated 3 November, the SEC has published a request for comment on the options discussed in the PWG's report. It is expected that structural change will follow for the US money funds industry – say by mid-2012; and that the EU will make any responsive changes necessary to ensure adequate alignment, thus avoiding regulatory arbitrage.

CESR's new two-tier definition regime for European money market funds is scheduled to be effective from July 2011. National regulators will consult on their respective changes. Most authorities are likely to adopt a simple "copy out" approach to implementation. There is still concern that CESR's chosen nomenclature fails to give adequate clarity, but this is unlikely to be revisited in the short term.

The conflict between MMF rule changes forcing them to invest shorter and the needs imposed on banks to fund longer creates a concerning conflict of objectives. Also, Basel rules may drive some restructuring of the industry, as banks with exposure to a constant NAV MMF elsewhere within their group may have to hold liquid assets against that exposure – to mitigate the possibility of having to inject liquidity in times of stress. This aspect is subject to national supervisory discretion, so it is still too early to be able to say how significant it will prove to be.

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European repo market

European Repo Council (ERC) White Paper: The ERC White Paper on the working of the repo market – was published on 13 July. Amongst the topics covered were specific concerns related to aspects of the market infrastructure in Italy, Spain and Greece. By way of follow up the White Paper's author, Richard Comotto, drafted an annex to provide an update primarily concerning subsequent developments in Spain, which was published on 17 December. Also that day the ERC, together with representatives of the European Primary Dealers Association (EPDA), met with representatives of the Bank of Greece and the Greek Public Debt Management Agency, in Athens. A further White Paper update, regarding applicable developments in Italy and Greece, may be produced during 2011.

Liquidity and capital: As reported in the Fourth Quarter Newsletter, in the 26 July press release from the BIS, the Group of Governors and Heads of Supervision (GHoS) announced that they had reached broad agreement on the Basel Committee of Banking Supervision (BCBS) capital and liquidity reform package. Dated 12 September, there was a further press release from the BIS, in which the GHoS announced a substantial strengthening of existing capital requirements and fully endorsed the agreements reached on 26 July 2010.

At its meeting on 30 November and 1 December, the BCBS agreed on the details of the Basel III rules text, which includes global regulatory standards on capital adequacy and liquidity. Then on 16 December the BCBS issued the Basel III rules text, which presents the details of global regulatory standards on bank capital adequacy and liquidity agreed by the GHoS, and endorsed by the G20 Leaders at their November Seoul Summit. The BCBS also published the results of its comprehensive quantitative impact study (QIS). The rules text presents the details of the Basel III Framework, which covers both micro-prudential and macro-prudential elements. The Framework sets out higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the build up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards.

Concerning transition and implementation, the BCBS has put in place processes to ensure the rigorous and consistent global implementation of the Basel III Framework. The standards will be phased in gradually so that the banking sector can move to the higher capital and liquidity standards while supporting lending to the economy. With respect to the leverage ratio, the BCBS will use the transition period to assess whether its proposed design and calibration is appropriate over a full credit cycle and for different types of business models. Based on the results of a parallel run period, any adjustments would be carried out in the first half of 2017 with a view to migrating to a Pillar 1 treatment on 1 January 2018 based on appropriate review and calibration. Both the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) will be subject to an observation period and will include a review clause to address any unintended consequences.

CCP exposures: On 20 December, the BCBS issued a consultative paper on the capitalisation of bank exposures to central counterparties. These proposals relate to the capitalisation of bank exposures to a central counterparty (CCP) and, in particular, default fund exposures. Generally speaking, the Committee proposes that trade exposures to a qualifying CCP will receive a 2% risk weight. In addition, default fund exposures to a CCP will, in accordance with a risk sensitive waterfall approach (based on a CCP's actual financial resources and hypothetical capital requirements), be capitalised according to a method that consistently and simply estimates risk arising from such default fund.

The Basel II Framework allows exposures to CCPs to be nil – and, as such, provides significantly reduced capital charges for banks. As part of the Basel III reforms, the Committee has materially changed the counterparty credit risk (CCR) regime. These changes significantly increase the capital charges associated with bank OTC derivatives and securities financing transactions (SFTs) and thereby (even though it is now proposed that there be an increase from nil to 2%) create important incentives for banks to use CCPs wherever practicable. As anticipated, it is proposed that the 2% risk weight is only available in relation to CCPs which are compliant with applicable CPSS-IOSCO standards. The small but positive capital charge is intended to ensure that banks track and monitor their exposures to CCPs as part of good risk management and to reflect that even trade exposures to compliant CCPs are not risk free. Notwithstanding the general 2% proposal, where collateral posted has been segregated and is held remote from the bankruptcy of the CCP holding the collateral, no counterparty credit risk capital charge is required as a result of the bank posting such collateral.

Consultation responses are requested by 4 February 2011. An impact study will also be conducted, based on CCPs data as of 31 December 2010 – which is to be submitted by end-January. The proposed rules text will be further refined in March-June 2011 and finalised once the final CPSS-IOSCO standards are published during 2011 (after a public consultation starting in spring 2011). As such, national implementation by January 2013 should be possible.

Derivatives and market infrastructures: As reported in the Fourth Quarter Newsletter, on 15 September, the Commission adopted a Regulation on OTC derivatives, central counterparties and trade repositories. The proposal has now passed to the Council and the European Parliament (EP). The procedure is standard co-decision. Member States undertook at the June 2010 European Council to conclude all negotiations relating to G20 commitments on financial reform by the end of 2011. In line with G20 commitments, the new rules should be fully in place and operational by the end of 2012. Work in the Council has been rapidly progressed and on 7 December the Council published the latest Presidency compromise proposal, reflecting suggested amendments to the Commission draft. Following discussion of this at its 10 December meeting, the Presidency has produced a progress report summarising the main outstanding issues. The incoming Hungarian Presidency will take forward the work on this proposal.

On 30 November, the EP's Economic and Monetary Affairs Committee (ECON) held an exchange of views on the related work of its rapporteur, Werner Langen. The rapporteur broadly welcomed the Commission's proposal, which reflects many of the points made in his EP own-initiative report – adopted in June 2010. However, he also noted several issues which will now be developed in his report for the EP, which is planned to be ready by the end of January 2011. The deadline for amendments will be in February, with ECON then voting in March – clearing the way for a July Plenary vote.

Short selling: In June the European Commission consulted on short selling. The ERC Committee responded to this consultation by submitting a copy of the ERC's White Paper. In September, the Commission then published a draft legislative proposal, in the form of a Regulation. (See the article on short selling in the next section of this Newsletter.)

Article 13 has particularly attracted the ERC's attention, as it places the onus on the trading venue or CCP to buy in the relevant securities to ensure delivery for settlement in the case of fails. The view of the ERC Committee is that trading venues are not the appropriate level for any necessary buy in of securities. Given concerns that the current proposal would prove unworkable it is contemplated that there should be a total removal of this article, with appropriate follow-up in the context of the settlement regulation consultation that is now also underway.

Netting Directive: In their 2007 evaluation of the implementation of the EU Collateral Directive the European Commission recognised that improvements are needed to the EU's *acquis communautaire* regarding netting and set-off. Concern regarding this deficiency has been heightened by the financial crisis. The Commission has determined that this should be fixed through a new EU legal instrument, rather than by amending an existing legislative instrument, and hence now proposes to bring forth a draft Netting Directive in 2011.

On a related note, the ERC has observed that the Commission's 20 October *Communication on Crisis Resolution* includes a statement that: "…the Commission considers that the framework should include provision for a temporary stay on rights to close out netting where authorities transfer relevant contracts as part of a resolution measure, and will consult with experts on the details of such a provision. Further consideration may also need to be given to the exercise of close out rights in connection with early intervention measures." The ERC is carefully considering the impact of such potential provisions.

On 6 January, the Commission launched a consultation on technical details underpinning its proposed crisis resolution framework. This features further elaborated points in a section on "Temporary suspension of rights" (starting on page 64), especially that part headed "Temporary suspension of close out netting (G13)"; and a section on "Safeguards" (starting on page 69), especially that part headed "Appropriate protection for financial collateral, set-off and netting arrangements (H2)."

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GMRA 2000 review

Over a year ago, ICMA asked its ERC Committee to provide feedback on the functioning of the GMRA in the face of the financial crisis and in particular in the fall-out which followed the collapse of Lehman Brothers. The feedback received indicated that the GMRA had generally performed well throughout the crisis. In order secure the GMRA's standing as the foremost agreement for documenting cross-border repo transactions, in late 2009, the ERC Committee put together a working group to consider whether any amendments were necessary to the GMRA 2000.

In meetings over the last year, the GMRA Review Working Group, made up of legal practitioners as well as market participants, considered:

- lessons learned from the financial crisis;
- amendments recently made to other master agreements (eg the GMSLA);
- feedback of SIFMA's MRA Review Working Group;
- bilateral feedback of GMRA users – gleaned from queries to ICMA's Legal Helpdesk and from our discussions with ERC member firms; and
- the recommendations of the European Financial Markets Lawyers Group (EFMLG).

The GMRA Review Working Group is now nearing the end of the review process. In consultation with the ERC Committee and with the kind support of Freshfields Bruckhaus Deringer, the Working Group has produced a revised GMRA, the "GMRA 2011". Some of the changes being made to the agreement are administrative in nature, eg changes to systems references. Other amendments intend to bring the agreement in line with other master agreements, eg drafting alterations to achieve greater consistency of definitions. A further set of changes affect commercial aspects of the agreement. The GMRA 2011 and an associated update protocol will be published alongside the 2011 update of ICMA's GMRA legal opinions in spring of 2011.

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Prospectus and Transparency Directive amendments and PRIPS consultation

On 11 December 2010, Directive 2010/73/EU was published in the *Official Journal* of the EU. It amends the Prospectus Directive (PD) and the related Transparency Directive (TD).

The amending Directive entered into force on 31 December 2010 (the 20th day following its publication), with EU Member States required to transpose its provisions into national law by 1 July 2012. ICMA anticipates that some Member States may seek to transpose the amending provisions in stages and/or well ahead of the July 2012 deadline. ICMA is seeking to monitor developments in the main financial jurisdictions in this respect and is also working on revising the model EU selling restrictions set out in its IPMA Handbook (to be re-branded as the "ICMA Primary Market Handbook").

The main changes are substantially unchanged from those described in the Third Quarter edition of this Newsletter (at page 19) and include an increase in the €50,000 thresholds to €100,000. (See the next article below on these aspects). A specific consequence of *Official Journal* publication is that €50,000 denominated bonds issued from 31 December 2010 are subject to the TD's full transparency regime rather than, as previously, its lighter "institutional" transparency regime (for new issues henceforth limited to bonds satisfying the €100,000 thresholds).

Whilst it is the national law of the "home" Member State for any particular transaction (ie where its prospectus will be approved) that will be most relevant, the laws of other Member States may also be relevant (notably in relation to public offer prospectus exemptions). Issuers may find it easier to work on an assumption of immediate pan-EU transposition of some of the amending provisions rather than attempting continuously to monitor a likely EU transposition patchwork. Another consideration for issuers in this respect will be the ability to effect subsequent issues of fungible bonds without impacting the applicable regime under the PD.

Distinctly, on 15 December 2010, Directive 2010/78/EU was also published in the *Official Journal*. It makes some further amendments (in Articles 5 and 7 respectively) to the PD and TD in the context of the transformation of the Committee of European Securities Regulators (CESR) into the European Securities and Markets Authority (ESMA) from 1 January 2011. Transposition of the relevant provisions into national law was therefore required by 31 December 2010.

Following from the above Level 1 changes, the EU authorities' next objective is a review at Level 2 of the PD's 2004 implementing Regulation. ICMA will continue to liaise with both EU and national authorities in this respect, in particular in relation to further detailing of the forms of summary and final terms.

On 26 November, the European Commission published a consultation on its Packaged Retail Investment Products (PRIPS) initiative (notably on the concept of a key investor information document – KIID). ICMA will likely be responding through its membership of the Joint Associations Committee on retail structured products. A general concern for ICMA is that solutions designed for the UCITS context are first transposed into the retail structured securities markets (which have their own distinct dynamics) and subsequently into the vanilla markets (which also have their own distinct dynamics) – potentially with insufficient consideration of these distinct dynamics in each case.

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Increase in the PD's €50,000 thresholds to €100,000

The PD amendments discussed in the previous article include an increase in the PD's €50,000 thresholds to €100,000 for the following reason set out in Recital 9: "The threshold of EUR 50 000 [...] no longer reflects the distinction between retail investors and professional investors in terms of investor capacity, since it appears that even retail investors have recently made investments of more than EUR 50 000 in a single transaction. For that reason it is appropriate to increase the said threshold and amend other provisions in which that threshold is mentioned accordingly."

One of the main priorities behind the creation of the PD is consumer protection. In the PD, EU authorities enacted (following intricate political negotiations) a pan-EU retail regime which includes substantial retail protections that act as disincentives (together with the intrinsic multiplicity of retail tickets and challenging national consumer protection legislation) for many issuers, who do not see a countervailing pricing, liquidity or other advantage in targeting retail investors, notably:

- the very wide PD definition of "public offer" and the consequential impractical requirement for prospectuses to cover multiple "cascade" secondary offers (the details of which are unknown to issuers);
- the tension between short/unpredictable market issuance windows and prospectuses (particularly base prospectuses for debt issuance programmes) having to remain up to date (and so supplemented and re-passported as necessary), particularly in the context of issuance programmes relied on in today's markets;
- the PD's specific disclosure requirements (including particularly potential IFRS restatement of financials, opinions on trends, auditor reports on forecasts, interim financials and potentially details of individual offers);
- the PD's general disclosure requirement for prospectuses to include all information necessary to enable investors to take their investment decision, which depends on the type of investor (the PD recitals state investor levels of expertise should be taken into account) – so necessitating retail prospectuses to be written in more detail (eg including information that institutional investors will already know and need not be told);
- the TD's ongoing disclosure requirements for securities admitted to trading on EU regulated markets – mainly publication of accounts in IFRS (as above) and interim financials within prescribed time periods.

Legislators did not intend retail protections to apply to institutional investors and so included in the PD a simpler and more appropriate regime for them. The proxy that was used was a minimum buy-in of €50,000. (Relying on the "qualified investor" provisions alone still requires the fuller disclosure for regulated market listing applications and post-listing ongoing disclosures.) A few EU Member States chose to exercise their discretion to allow certain retail investors in their jurisdiction to be treated as institutional investors in this respect.

ICMA informally stressed to the EU authorities (and to several others, including some buy side industry associations) that increasing the €50,000 threshold to €100,000 would have serious implications for institutional investors in terms of risk concentration and precise matching of assets to liabilities (particularly for those issuers unable to make use of incremental denominations of €1,000 above the applicable minimum threshold). However, it was made clear to ICMA that the increase was a major political priority amongst EU Member States, with an increase to €100,000 already a compromise from some Member States' insistence on a €250,000 threshold. This seemed to stem from reports of some retail investors in those Member States having mortgaged their homes to buy €50,000-denominated bonds.

Lead managers consulted by ICMA generally estimate that many issuers will continue to make use of an increased €100,000 threshold. Transactions using the increased threshold have been seen for some time (so in advance of *Official Journal* official publication, let alone national transposition) – this seems to have been occurring to preserve issuers' future ability to issue, under the PD/TD institutional regimes, bonds fungible with pre-existing transactions (as there is no PD/TD grandfathering for subsequent fungible issues and uncertainty regarding national transposition timelines). Furthermore, respecting the thresholds in foreign currency transactions requires round denominations that are certain always to be equivalent to €100,000 or more – US$200,000, for example.

EU Member States can seek to address their concerns for retail protection via a combination of (i) disclosure regulation (as in the PD and TD), (ii) intermediary/distributor regulation (as in MiFID), (iii) product regulation (as in UCITS) and (iv) retail investor education and responsibility. A loosening of one is likely to require tightening of another (for example potentially limiting MiFID's "execution only" exemption for vanilla bonds or extending intermediaries' obligations to explain investments to retail clients). ICMA intends to continue pursuing discussions with national and EU authorities in this respect. Development of a much-needed (particularly given looming generational challenges) pan-European retail market requires an appropriate balancing of retail protection with encouragement for borrowers to issue retail bonds.

Distinctly, ICMA is working with the two International Central Securities Depositories, Euroclear and Clearstream, to publicise that they can now, if required, apply minimum transfer restrictions (of, say, €100,000) on low denomination (eg €1,000) bonds, thus reducing reliance on the existing concept of bonds having "minimum denominations" of €50,000 and €1,000 increments thereafter (ie denominations being €50,000, €51,000, €52,000, etc.).

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Bookbuilding and allocations

Following coverage in the most recent editions of this Newsletter, ICMA has published Explanatory Note XIII in its IPMA Handbook.

The purpose of the Explanatory Note is to provide some practical information on pre-sounding, bookbuilding and allocation processes, as often used in the prevalent "pot" context of the European cross-border syndicated institutional primary debt markets.

As market practices are continually evolving and individual transactions are structured according to their specific circumstances, the Explanatory Note is not intended to prescribe or endorse particular structures or practices. Rather, it is intended to be a document designed to both enhance transparency for, and serve as a helpful point of reference to, bookrunners when explaining their working practices to colleagues, issuers and investors. It sets out common practices relating to pre-sounding, bookbuilding and allocation, noting that some issuers, intermediaries and investors may find useful in the context of their participation in individual bond issuance transactions. ICMA is looking forward to considering issuer and investor feedback on the Explanatory Note.

Distinctly, Section 7.3.7 (on page 72) of the Commission's MiFID Review consultation addresses underwriting and placing, noting possible options could include:

- requiring firms to establish specific organisational arrangements and procedures concerning all the different steps of the underwriting process (preliminary contacts with the issuer, formation of the syndication, pricing of the securities, actual issue of the securities, methods used to mitigate risk);
- introducing specific rules to deal with the allotment process, including conduct of business rules (for instance, information requirements towards issuers and investors concerning procedures and criteria adopted by the firm in distributing the financial instruments);
- addressing relevant practices through specific conflicts of interest requirements (a model noted to have been followed for conflicts of interests arising in the context of investment research.

ICMA's primary market constituency will be responding to the related Question 124 as part of ICMA's wider general response to the consultation (further described in the secondary markets section of this Newsletter). The response is likely to:

- highlight existing regulation of the underwriting process (notably MiFID regarding conflicts of interest and the Market Abuse Directive regarding pre-sounding);
- note, regarding the second possible option for further regulation, that the inflexibility of specific prescriptive rules will mean transactions subject to wildly varying market dynamics having to proceed in fixed and, so likely, sub-optimal conditions – impacting primary issuance success rates and related market funding confidence and supply;
- note that the third possible option of specific conflicts of interest requirements effectively results in institutional separation and so a return to the past separation of merchant banks and stockbrokers, which is inconsistent with today's syndicated issuance markets;
- note that neither of the above are supportive of a stable offering/borrowing environment that is needed now as much as ever to assist the wider European economy;
- offer to assist further in relation to the remaining option for specific organisational arrangements and procedures, which many firms have already been committing time and resource to developing.

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Other primary market developments

Legal certainty of securities holding and dispositions: ICMA will be responding to the Commission consultation on legal certainty of securities holding and dispositions, emphasising from the primary markets perspective at least: (i) the importance of the good discharge to issuers for sums paid to depositaries for the two International Central Securities Depositories (ICSDs), Euroclear and Clearstream; (ii) the validity of notices to holders delivered by issuers to the ICSDs; and (iii) the natural impact of differing holding chain lengths on the concept of equal treatment.

HIREA: ICMA has submitted a response to IRS Notice 210-60 *Information reporting and withholding under the Hiring Incentives to Restore Employment Act (HIREA),* notably highlighting the need for US tax law certainty regarding (i) the treatment of bearer bonds deposited in the ICSDs following HIREA repeal of certain TEFRA provisions and (ii) the compliance status of intermediaries that may cause withholdings to be suffered by others than themselves (namely the ultimate holders of the securities concerned).

UKLA: ICMA has submitted a response (emphasising the need for the UK Listing Authority (UKLA) to come under the responsibility of the Consumer Protection and Markets Authority (CPMA) rather than the Financial Reporting Council) and a follow-up letter (emphasising the need for the CPMA to balance appropriately its “consumer” and “markets” responsibilities) to the UK Treasury’s consultation cm7874: *A New Approach to Financial Regulation: Judgement, Focus and Stability* that was discussed (at page 18) in the Fourth Quarter edition of this Newsletter.

Japanese withholding tax: ICMA has been working on revising its 1998 and 2000 IPMA Japanese withholding tax procedure manuals.

EPIM: ICMA is liaising with the ICSDs as to the proposed mandatory extension of the EPIM system for ISIN allocation to MTN issuance from 1 February 2011 and the serious challenges faced by banks in establishing relevant systems in time.

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MiFID review: implications for fixed income markets

Timothy Baker

The past two Newsletters commented on CESR's consultations on the review of MiFID, and CESR's subsequent first and second sets of advice to the European Commission.

On 8 December, two months later than expected, the Commission's DG Markt launched its own consultation. Despite its commitment to good consultation practice, DG Markt has allowed only six weeks, until 2 February 2011, to respond. Moreover, we understand that a Regulatory Impact Assessment will be published only after the 2 February deadline has passed.

This hurry is doubly troubling, since in important respects DG Markt suggests new requirements which go well beyond what CESR advised, and which could have significant consequences for the conduct of European markets, the investors and issuers who use them, and the competitive position of Europe globally.

ICMA will respond, in coordination with other trade associations to which members belong. We will be calling on members for advice and input on both technical aspects and the overall tenor of the response.

Building on the earlier Newsletter articles, the following paragraphs compare DG Markt's new proposals with the CESR advice.

Post-trade reporting: DG Markt's proposal to extend MiFID requirements to a broad range of fixed income instruments is in line with CESR's advice. But it includes none of the detailed market by market assessment of CESR, which DG Markt plans to cover in later Level 2 legislation. The main concern of ICMA members is likely to be to calibrate, in line with users' needs, the proposed short delays before large trades in illiquid instruments must be published to the market; and to ensure proper differentiation for different markets. Notably, DG Markt adopts CESR's (possibly erroneous) assumption that bonds with a prospectus or which are admitted to trading on a Regulated Market or Multilateral Trading Facility (MTF) are the more liquid and more frequently traded market segment within the asset class.

Regulatory classification of OTC markets: DG Markt goes beyond CESR's advice with a proposal to establish a new class of regulated "Organised Trading Facility" (OTF) to cover trading mechanisms which do not fall into the existing MTF category. ICMA will need to study carefully the possible effect of this greater formalisation, and the associated rules, on OTC trading mechanisms.

Pre-trade transparency: Whereas CESR recommended no pre-trade transparency requirements for OTC fixed income markets, leaving them to the market or national discretion, DG Markt proposes to impose requirements on OTFs similar to those for Regulated Markets and MTFs, and also to impose an obligation, whose intended scope is not made clear, for OTC dealers to make their quotes public: these quotes (replicating the existing "systematic internaliser" regime for equities) are proposed to be binding up to a specified size. DG Markt follows CESR in proposing harmonised requirements on advertising fixed income trading interest on Regulated Markets and MTFs, taking account of differences between markets, and with waivers where appropriate. Additionally, DG Markt suggests that all Regulated Markets, MTFs, and OTFs publish pre-trade information in a "continuous manner", though the requirement to quote continuously would not apply to investment firms. Accordingly, thought will need to be given to how this would affect the "Request for Quote" model. The main concern of ICMA members is likely to be to ensure that any pre-trade transparency requirements take account of the tailoring and adaptation of current arrangements to users' needs.

Client classification and conduct of business: CESR advised the Commission, in line with ICMA's views, that the existing threefold client categorisation (retail, professional, counterparty) works well. CESR proposed only small adjustments to the regime. DG Markt suggests a more radical revision, the overall thrust of which is to limit firms' ability to treat clients as professionals or counterparties, and to impose on business with professionals and counterparties more stringent conduct of business rules similar to those for retail clients. New more stringent rules on assessing the expertise of clients, providing information to them, and restricting the ability to trade with or for them, could apply particularly for "complex" instruments. While it may be appropriate to require better disclosure about instruments and the risk attached to them, ICMA Members are likely to be concerned that widespread restriction of the assumption that professionals have expertise, and widespread imposition of retail protections, could significantly impair EU fixed income markets.

EU intervention in markets: In an area not covered by CESR, DG Markt suggests certain mechanisms for EU-level oversight and intervention in markets, including limitation of derivative positions and the ability to ban certain products or activities which imperil market or systemic stability or investor protection. ICMA members are likely to be concerned to ensure that any such powers are controlled by stringent due process and do not impair market confidence.

Changes to equity trading transparency: As noted above, DG Markt, going beyond CESR's advice, proposes to copy across to non-equity markets, perhaps unthinkingly, several aspects of the regulation of trading and market transparency for equities. Sometimes, for example the suggested requirement to publish dealer quotes, the regime for non-equities appears even more stringent than for equities. It will be important to consider the suitability for fixed income markets of some of the equity-based proposals, for example on automated trading and trade data consolidation.

Underwriting and placing. DG Markt follows CESR in suggesting MiFID rules on conflicts of interest where a firm acts on behalf of both issuer and investor. (See the primary markets section of this Newsletter.)

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Short selling

The Fourth Quarter Newsletter outlined the European Commission's proposed Regulation on Short Selling. This proposes that:

- there should be a two-tier transparency model;
- persons entering into short sales of shares or sovereign debt must, at the time of the sale, have borrowed (or arranged to borrow) the instruments ready to settle;
- trading venues must ensure there are adequate arrangements in place for the buy-in of shares or sovereign debt where there is a failure to settle;
- certain exemptions are provided for, including market making and stabilisation; and
- competent authorities have certain incremental emergency powers, including introducing bans.

The Commission's proposal is now under consideration by the *Council* and the European Parliament. The Council has made some progress in its thinking. On 19 November, a Presidency compromise text was published, featuring several suggested amendments. The Presidency has now produced a progress report summarising the main outstanding issues:

- *Scope*: Some delegations strongly oppose the inclusion of sovereign debt instruments within the scope of the Regulation.
- *Marking of short orders on trading venues:* Some delegations are not in favour of the proposal to oblige trading venues to introduce procedures to mark short orders and to publish daily summaries of short orders. They argue this would not withstand a cost-benefit analysis and it might drive business out of trading venues.
- *Restrictions on uncovered short sales:* Some delegations feel there is insufficient evidence to impose permanent restrictions on short selling especially in relation to sovereign debt instruments.
- *Buy-in procedures for fines and late settlement:* Some delegations feel that there is a lack of evidence of a causal link between short selling and settlement failures and therefore oppose the proposals to enhance settlement discipline. Others feel the draft Regulation on Short Selling is not the appropriate text in which to address this issue.
- *Intervention powers of ESMA:* A number of delegations believe the emergency powers given to ESMA (to intervene in case of unjustified inaction by a competent authority) go too far and/or they do not want ESMA to intervene in the sovereign debt market.
- *Delegated acts:* Some delegations want to strengthen the conditions for delegated acts by the Commission. Some have also called for more implementing technical standards by ESMA.

The Presidency report concludes that further technical debate is necessary before seeking guidance at political level as to the options to be followed. The incoming Hungarian Presidency will take forward the work on this proposal.

The European Parliament published the first draft of its report on short selling on 24 November. The report was drafted by rapporteur Pascal Canfin, of the Green party, and on many issues goes further than the original Commission proposal, eg:

- extending the scope of the regulation to corporate debt instruments;
- banning naked sovereign CDS;
- introducing transparency requirements on "leveraged long positions in shares";
- restricting the application of the market maker exemption and tightens the definition of market maker for the purpose of the exemption; and
- extending the regulation to covers transactions conducted OTC.

Notably the report, while recognizing that there are no conclusive academic studies on the impact of the recent short-selling, nevertheless goes on to outline five negative effects of short selling which "are largely accepted":

- increased volatility and a risk of the markets overreacting;
- increased risk of market abuse, notably intraday;
- inflation of securities and risk of squeeze;
- increased risk of settlement failure; and
- reinforcement of distortions linked to asymmetric information and significant impact on financial conditions.

The Canfin report was the subject of an exchange of views in ECON on 13 December (there was a preliminary ECON discussion on 9 November). Mr. Canfin has indicated his determination to move faster than the EU Council of Ministers and has advocated a January 17 deadline for MEPs to table amendments, to be followed by consideration of the amendments on February 7 and a February 14 vote in ECON (for formal adoption of the Canfin report). This would then be followed by a plenary vote adopting the agreed regulation in early April. Once adopted the Regulation would apply from 1 July 2012.

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ICMA Secondary Market Rules and Recommendations: Usage Review

The Fourth Quarter Newsletter reported that ICMA had sent an electronic survey to members asking about the extent to which ICMA's Secondary Market Rules and Recommendations are used in the market. The survey also asked for views on secondary bond market trading volumes. All members received several e-mail invitations and the majority were additionally contacted by phone.

Of ICMA's 380 members (as of the end of September), responses were received from 150 members. This amounts to 39% of ICMA's membership (for several companies, different subsidiaries and country offices are counted as separate members). Of these 150 responses 84 responses only provided contact details and did not complete any of the substantive questions so their responses have not been included in the data analysis. A further two responses were excluded as duplicate responses. The remaining 64 responses form the basis of the subsequent data analysis that ICMA has performed.

The next step is to consider whether ICMA should be recommending any changes to its Secondary Market Rules and Recommendations, in the light of the responses received. ICMA is convening a meeting of its Secondary Market Practices Committee in January to discuss this.

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Personal view on the secondary markets by John Serocold

I am very excited to be joining ICMA at a time when financial market reform is high on the agenda. Since joining LIBA in 2000, I have been involved in market structure questions, supporting firms through a wide range of market efficiency initiatives: the introduction of a CCP for UK cash equities, a campaign to reduce the frictional costs of trading, adapting to the post-MiFID landscape and so on. I also dealt with a number of exchange mergers, which were impelled in part by a desire for efficiency and in part by a desire to consolidate and wield market power.

There are two main structural questions for fixed income markets in 2011: first, what blend of market structures best suits investors and issuers today? And second, how to respond to calls for greater efficiency and transparency?

International bonds are held by a wide variety of investors, through a wide variety of investment vehicles. The international markets should be attractive to industrial, financial and sovereign borrowers. It follows that no single mode of trading – a public limit order book, an auction or a dealer market – will satisfy everyone's needs. Rather than compromise, market structures should show diversity and innovation. That also means taking advantage of advances in technology, perhaps re-using platforms developed for other markets. As ever, these questions are not only technical, but also political.

The political element is coming to the fore as the MiFID review gets underway. The latest consultation paper from the European Commission covers a wide area at a high level. But the new Directive has the potential to have as much impact on established structures over a wide radius as the 2004 text. As well as bonds, derivatives, swaps and commodities are within scope. At present, though, despite a year of work and copious technical advice from CESR, much of the Commission's thinking is at quite a high level – though where it descends into detail, the policy orientations are not always to our industry's advantage. This provides a limited window of opportunity for the industry to coalesce around a range of solutions, which it can push forward, demonstrating to policymakers the market's ability to heal itself.

Developments elsewhere will also have an impact: ICMA members will need to consider where to deploy capital, as reforms to financial regulation begin to bite. The current economic conjuncture, overlaid by market participants' concerns about progress in resolving the interlinked questions of sovereign debt and the safety and soundness of the banks, will continue to provide a challenging backdrop to ICMA's technical and regulatory work.

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Industry trends in asset management

At the ICMA Asset Management and Investors Council (AMIC) meeting held on 14 December in London, Dr Massimiliano Castelli, Senior Strategist at UBS Global Asset Management, gave a presentation on the key industry, investment and regulatory trends affecting the asset management industry.

Over the medium-to-long term, asset management remains an attractive industry whose growth is sustained by three key drivers: (1) ageing population, particularly in advanced economies but also in some less advanced economies; (2) emerging markets whose strong growth translates into high household saving; (3) increased future saving for retirement. This latter factor has become even more important in the post-crisis years as a result of wealth destruction that occurred during the financial crisis. Following the drop experienced in 2008 and early 2009, in the course of 2010 there has generally been a gradual recovery in asset margins reflecting a rise in the value of assets and gradually recovering investors' risk appetite. However, margins still remain very volatile reflecting the still uncertain behaviour of investors.

Some of the trends already well in place before the crisis – though at a different pace – continued in 2009-10. Independent asset managers continued outgrowing the captives thanks to focus, dedication and ability to attract and retain talents; captive asset managers – however – are capable of offering bigger balance sheets and a broader set of financial solutions. Open "guided" architecture is growing in importance in the retail market and the growing importance of fiduciary and advisory services. These trends are likely to continue as they appear structural rather than cyclical.

What makes 2009-10 different from previous periods following global recessions is the slow pace at which investors' appetite is picking up. Despite a large amount of cash having been taken out from money market funds in 2009-10, the amount of funds flowing into riskier asset classes such as equity is growing slowly. Households are also investing less in mutual funds and have a preference for bank deposits, probably reflecting a decreased trust in funds as a result of the financial crisis.

The low risk appetite among investors is mostly a reflection of the uncertainty still surrounding the global economy in the after-crisis period. Although the global recovery is well in place – though at an uneven pace across regions – the medium-term outlook continues to appear uncertain and this is affecting the behaviour of investors. For instance, the uncertainty over the ability of some European nations to service sovereign debt; or the continuing deleveraging in the private sector preventing aggregate demand from fully recovering to the pre-crisis levels; or the spectrum of inflation/deflation as some countries could choose to inflate their way out debt or should a double-dip scenario materialize in the US. This uncertainty is driving the mindset of investors in terms of simplicity (investment products whose performance in volatile markets is easy to understand), liquidity (low cost investments as investors want to be dynamic and get in and out of asset classes depending on macro sentiment), diversification (portfolios built across various asset classes, including alternatives) and search for extra yield (exposure to parts of the world with a stronger economic outlook).

These investors' needs translate into well identified industry trends, including: (a) continuing growth in passive investments, including ETFs, multi-asset funds, rules-based indices and low-cost alternatives to traditional funds; (b) growth in products providing exposure to emerging markets; (c) more sophisticated client portfolio management with a focus on diversification, liability and dynamic asset allocation; (d) continued growth in alternative funds, particularly hedge funds; (e) the increased importance of so-called hard assets (real estate, infrastructure, private equity, commodities) which are very useful inflation risk diversifiers.

With regards to the regulatory trends affecting the industry, while asset management is less impacted than other parts of the financial service industry such as investment banking, there are some specific regulations which will have significant implications in the next few years. In the US, FATCA and the Volcker rule appear to be the two important pieces of regulation affecting the asset management industry. FATCA, in particular, poses a great challenge for the industry and the costs involved could be substantial if some simplification is not foreseen in the implementation phase. The recent change in the US political majority is unlikely to lead to any significant reversal in this trend; hopefully a more pragmatic approach will be adopted in the

Industry trends in asset management
– continued

phase of execution. In Europe, the industry is confronted with several new EU-wide regulations and national legislative initiatives. At EU level, the recently approved Alternative Investment Fund Directive (AIFM) – while less damaging than feared a few months ago – will have implications which remain very much dependent on how the Directive will be implemented at Level 2 legislation. The recent rules on remuneration included in the Capital Requirement Directive (CRD III) are the most stringent globally and risk putting EU-based fund managers at a disadvantage when compared to other jurisdictions, including the US. Other pieces of EU regulations relevant for the industry include MiFID, UCITS IV and depositaries. Finally, sometimes diverging national regulations – ie such as those concerning the bank levy – carry the risk of market fragmentation and distortions.

Dr Massimiliano Castelli
Senior Strategist, UBS Global Asset Management

Over-reliance on credit rating agencies

As discussed earlier in this Newsletter, constraints on the use of credit rating agencies (CRAs) came into force according to Article 4(1) of the EU's Credit Rating Agencies (CRAs) Regulation on 7 December.

On 27 October, the Financial Stability Board (FSB) released at global level its *Principles for Reducing Reliance on Credit Rating Agency (CRA) Ratings.* The European Commission published in turn a new consultation on the issue of overreliance on CRAs on 5 November. The consultation aims at promoting better due diligence; considers internal risk management models; and calls for a change in the role of ratings in the light of their potential impact on investors' behaviour.

The main themes in the Commission's consultation paper are:

- reducing over-reliance on external credit ratings (by suggesting the use of an internal credit risk assessment process and of a mix of alternative measures);
- enhancing sovereign debt ratings (among others, one of the proposals is to reduce the assessment time period from one year to six months and increase the documentation disclosed by rating agencies);
- enhancing competition in the credit rating industry (through public, private or joint initiatives);
- proposing civil liability of CRAs; and
- Eliminating potential conflicts of interest owing to the "Issuer-Pays" Model.

In relation to the consultation paper, a draft report on credit rating agencies was published by the European Parliament's Committee on Economic and Monetary Affairs (ECON) on 24 November. Amongst other things, the draft report and subsequent discussions at ECON level focused on:

- over-reliance on CRAs (market participants should not invest in structured products if they cannot assess the underlying credit risk themselves; alternatively they should apply the highest risk weighting);
- establishment of a fully independent European Credit Rating Foundation (ECRaF);

- disclosure and access to information so as to enable investors to assess risk and to fulfil their due-diligence and fiduciary duties, especially in the field of structured finance;
- more sophisticated market players should use internal models to assess sovereign credit risk because of the greater public information available;
- a dual system of ratings in the case of structured securities used for regulatory purposes;
- an "Investor-Pays" Model to address conflicts of interest;
- accountability, responsibility and liability of CRAs (CRAs do not just provide opinions).

The AMIC is of the view that reforms, while desirable, need to be well conceived in order to maintain the "public good" aspects of credit ratings and to avoid unintended consequences such as increased costs and reduced access to capital markets. Credit rating agencies provide an assessment of the creditworthiness of a corporation or security, based on the issuer's quality of assets, existing liabilities, borrowing history, and overall business performance. Credit rating agencies offer the issuing company the opportunity to use and communicate non-public information externally, without disclosing its precise content. This is a critical aspect of a functioning international capital market.

The current regulatory framework is so reliant on ratings that significant changes can only take place over time. Mandates to use ratings have become part of the fabric of financial markets, and cannot be unwoven instantaneously. Many institutional investors are legally obliged to hold only securities of some minimum rating, or may have to hold larger reserves when investing in bonds with lower ratings. Ratings are also used in private contracts, for example to define the investment objectives of bond mutual funds. Accordingly, the AMIC believes that the regulatory use of ratings has exacerbated pro-cyclicality in the financial system as a whole. However, in order to reduce private reliance on ratings, credible alternatives or substitutes should be developed, particularly for institutions that lack resources to assess independently the number of available fixed income instruments.

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Covered bond market developments

Disclosure requirements – Bank of England market notice: In July 2010, the Bank of England released a statement about expanding eligible collateral in the discount window facility and information transparency for ABS. UK members of the Covered Bond Investor Council (CBIC) discussed the implications of the market notice for the UK covered bond market. The Bank of England published in December its market notice detailing eligibility requirements for residential mortgage backed securities and covered bonds backed by residential mortgages. The market notice explains that transaction documents will become an eligibility requirement from July 2011. The Bank expects issuers who intend for their securities to be eligible for use as collateral with the Bank should use this period to put in place the systems and processes required to enable compliance with the criteria.

In a nutshell, the Bank of England has decided to require granular information on a loan-by-loan basis, so that investors can make their own stratification tables about the cover pool. It considers that investors do not have the same requirements regarding stratification tables, and it is easier to leave it up to each investor to compile tables with the loan-by-loan information. Issuers will have to present different types of documentation as a result of this market notice.

In order to be eligible in the Bank's operations, the following requirements will apply to RMBS and covered bonds backed by residential mortgages:

- *Loan level information* (see residential mortgages loan level data template): this is granular, in the form of an Excel sheet table.
- *Transaction document:* this will be made available to investors, potential investors and certain other market professionals on their behalf.
- *Transaction summary* (see transaction overview template).
- *Cash flow models:* a waterfall cash flow model will be required to be made available to investors.
- *Access to information:* all the information must be made available via a secure website managed by or on behalf of the Information Provider.

In the case of non-UK transactions, RMBS and covered bonds backed by collateral from non-UK jurisdictions will be required to comply with the Bank's eligibility criteria.

Disclosure requirements – Bank of Spain legislative developments: A new law in Spain obliging issuers to disclose detailed information on the composition of, and underwriting criteria for, assets backing covered bonds, has now officially been published, and is due to come into effect in 2012. The standards of transparency in the new law are not as high as those of the Bank of England. Data will be made available on an annual basis; LTV data will be available on the eligible part of the pool and not the whole cover pool; there will be some breakdown as regards the different types of loan in the cover pool. The criteria for the breakdown are as follows:

- *Origination type:* those originated by the issuer entity, those derived from creditor subrogation, purchase or others.
- *Currency:* those in euro and in other currencies.
- *Arrears:* those where payment is current, those falling due and payable, in arrears and in default.
- *Average remaining terms:* up to 10 years; >10 to <=20 years; >20 to <=30 years; >30 years.
- *Interest rate type:* fixed rate, variable rate, mixed rate.
- *Loan purpose:* those used by individual and company borrowers for financing real estate developments, and those used for residential purchase.
- *Property type:* whether the buildings are constructed (split between residential use, commercial use and others); on urban land and other land; and whether the properties are subject to any official subsidy scheme.

Norway – transparency template discussion: On 6 December, the CBIC Chairman, Claus Nielsen of Norges Bank, met the Norwegian Financial Trade Association (FNO) to discuss the possibility of creating a national transparency template on the basis of a list of transparency requirements the CBIC has prepared. The CBIC anticipates to be consulted further on this issue.

SME loans in the cover pool of covered bonds: On 29 July, the UK Government published a consultation paper reviewing access for businesses to a diverse range of sources of finance that suits their needs. In Chapter 4, entitled *Future Challenges,* the consultation paper reviewed, *inter alia*, securitisation as a source of funding for both banks and non-bank lenders. The CBIC responded to the consultation specifically commenting on parts of the paper directly affecting the covered bond market and specifically on the inclusion of SME loans in the cover pools for covered bonds. It is understood that the French Senate has asked the French authorities to reflect on this possibility as well. The CBIC will be looking at this question in more depth in the coming year.

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IOSCO regulatory oversight principles for dark liquidity

The Technical Committee of IOSCO published a consultation report entitled *Issues Raised by Dark Liquidity* containing six draft principles to assist securities market authorities in dealing with issues concerning dark liquidity. The principles are designed to: minimise the adverse impact of the increased use of dark pools and dark orders in transparent markets on the price discovery process; mitigate the effect of any potential fragmentation of information and liquidity; help to ensure that regulators have access to adequate information to monitor the use of dark pools and dark orders; help to ensure that investors have sufficient information so that they are able to understand the manner in which orders will be handled and executed; and increase the monitoring of dark orders and dark pools in order to facilitate an appropriate regulatory response. Dark pools are run by independent operators, such as Liquidinet, by banks (crossing networks) or sometimes by exchanges themselves. They have existed for many years in investment banks but they have attracted greater attention since the introduction of MiFID in 2007.

The consultation period for the IOSCO paper closes on 28 January. While AMIC members welcome the IOSCO report at this stage, it also needs to be considered in the light of the Swinburne report, approved on 14 December, as well as the MiFID review.

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AIFM Directive

The ECON Committee of the European Parliament has agreed on a final text to the AIFM Directive which will include clauses on asset stripping and remuneration as well as a compromise on marketing passports. The agreed text is set to impose a passport system and registration, reporting and capital requirements on companies. It also includes depositary liability, capital requirements and rules covering leverage use. The main regulatory component is an obligation for EU-based managers of alternative investment funds to register and disclose their activities. This includes divulging investment strategies and accounting practices to investors and regulators. Hedge fund managers will also be required to retain minimum capital requirements and ensure these assets are secured in depositary banks.

The text of the AIFM Directive also allows non-EU hedge funds and private equity firms to market to investors across the EU without having to seek permission from the Government of each Member State. The European Parliament had pushed for a marketing passport to be granted to non-EU participants. But under a compromise with Member States, MEPs agreed that managers will obtain passports only if the non-EU country in which they are located meets minimum regulatory standards and has agreements in place to allow information sharing. Initially only EU AIF and AIF managers will be able to obtain a passport, with those based outside the EU having to market through the current national private placement regimes. After an opinion from ESMA and the adoption of implementing legislation by the Commission, the passport will then also become available to non-EU AIF and AIF managers.

In addition a new clause has been inserted to ensure that fund managers will have to obey the same rules as those for banks to remove incentives for excessive risk-taking.

Although the Commission's very first proposal had already dealt with regulating depositaries' liability, MEPs considered that too much leeway was being given to depositaries to delegate this liability. To this end, MEPs inserted a clause stating that, if a depositary legally delegates its tasks to others, then it must provide a contract which allows the fund or the fund manager to claim damages against the entity which received the delegation. This should ensure that at no point in the chain will liability be irretrievably lost. MEPs also secured a requirement that the AIF investors concerned are closely involved with the potential delegation of liability.

CESR has now published a call for evidence on Level 2 measures. The AMIC will be making general comments on the impact of the implementing measures on the institutional investors' community.

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Taxation and automatic exchange of information

Divergence of views: The Belgian EU Presidency discussions on the reinforcement of administrative cooperation in taxation matters, held at the Committee of Permanent Representatives (COREPER) on 13 October, revealed a wide divergence of opinions between the delegations. The discussions mainly concerned the provisions of the future EU directive relating to the automatic exchange of information made available to tax authorities on the financial status of non-residents.

In its compromise proposal, the Belgian Presidency proposed that the system should apply from 2015 onwards to eight categories of income and capital: from employment; director's fees; life insurance products not covered by other Community legal instruments on exchange of information and other similar measures; pensions; ownership of an income from immovable property; dividends; capital gains; and royalties.

The Belgian compromise allows a Member State to refuse to cooperate with another Member State if information required on a taxpayer relates to a taxable period prior to 1 January 2010. But Luxembourg and Austria suggested that the selected date should be the same as for the directive coming into effect, namely 1 January 2011, or as soon as possible.

ECOFIN compromise: Subsequently, the Council published a press release concerning strengthening administrative cooperation in the field of direct taxation.

The December ECOFIN decided to implement the OECD model tax convention on income and capital in the EU so as to combat tax fraud. The discussion concerned the overhaul of Directive 77/799/EC on which administration cooperation in the field of cooperation has been based since 1977.

Specifically, the Council defined those pieces of information which have to be exchanged on request, as well as a regime of automatic exchange of up to eight categories of information – this is expected to follow a step-by-step approach. The scope of the proposal covers: income from employment, directors' fees, capital gains, royalties, certain life insurance products, pensions, ownership of and income from immovable property.

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UCITS V

The Commission has now launched a consultation on the *Review of the EU Rules for Setting Up and Operating UCITS.* The Commission intends to present a new legislative proposal to update the framework applicable to UCITS depositaries and to introduce new provisions on the remuneration of UCITS managers. The consultation has been launched in response to the Madoff fraud case and the Lehman bankruptcy.

This consultation follows on from the Commission's first public consultation which aimed at strengthening the regulation and supervision of UCITS depositaries and also asked whether the UCITS framework in this area needed to be further harmonised and strengthened, so as to ensure a level playing field in terms of UCITS investor protection measures across all Member States. A feedback statement published in 2009 stated that the clarification of the UCITS depositary function was an essential step for a comprehensive review of the existing European regulatory principles applicable to depositary functions. The same year, the Commission published a proposal in order to regulate alternative fund managers, which also introduced some provisions applicable to the depositary function in order to "provide a better and more transparent regulation of the entity holding the fund's assets and to offer an appropriate level of investor protection".

According to the consultation paper, the Commission is committed to introduce *targeted changes to the depositary provisions* in the UCITS Directive. This change aims at clarifying the UCITS depositary function – by ensuring consistency between the legislation applicable to the depositaries of UCITS and that applicable to the depositaries of alternative investment funds – with a view to improving the level of investor protection.

The consultation paper also puts forward *changes to UCITS depositary liability* in relation to lost financial instruments and clarification of UCITS depositary liability in case of loss of assets by a sub-custodian. It proposes additional restrictions on delegation to sub-custodians, requirements to provide information to investors on sub-custodian networks used, and more detailed rules on due diligence requirements when appointing sub-custodians. The paper also suggests reversing the burden of proof, so that the burden will be on depositaries to demonstrate they have fulfilled their duties. The Commission further suggests aligning investor rights so that investors have the right to claim in relation to the liabilities of depositaries either directly or indirectly through the management company.

On *UCITS managers' remuneration,* the Commission says that the financial crisis showed that incentive schemes within financial institutions often contributed to short-termism and excessive risk taking. The Commission is extending its work on remuneration in other financial sectors to cover the managers of UCITS, which is says is a "natural step". The Commission suggests that remuneration policies for UCITS managers should be designed to promote sound and effective risk management, and discourage any risk-taking which is inconsistent with the risk profiles and fund rules of instruments of incorporation of the managed UCITS. Remuneration policies should also prevent conflicts of interest and ensure the protection of the interests of clients and investors in the course of collective portfolio management activities. As for scope, the Commission proposes that obligations relating to remuneration policies should apply to the UCITS fund manager (which may be a management company or a self-managed investment company) and should cover remuneration of any type paid to the staff of the manager, whether paid by the management company or directly by the fund.

The consultation is open until 31 January. The Commission aims to publish legislation shortly after this deadline.

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Corporate governance

The Industry Code: Last summer, the Financial Reporting Council (FRC), the UK's corporate governance regulator, announced the launch of *The Stewardship Code* – seven principles that call on institutional investors to disclose how they will go about enacting corporate change, how they vote, and how they scrutinise company conduct. As the first code of its kind in the world, corporate governance experts hope the guidelines will be an important step in developing a more robust corporate governance culture. A key aspect of the code will be to enhance the ability of institutional investors to collaborate on governance issues.

Since the publication of the Code in July, institutions have continually issued statements of support for its principles, which aim to improve the level of communication between shareholders and company boards.

According to the FRC, international groups such as the Australian Council of Superannuation Investors, are among those that have backed the scheme during the first few months. Baroness Hogg, Chair of the FRC, has said that "a critical mass of investors is coming through and this is a very important first step"; and that productive discussions between board members and shareholders are "an essential part of good governance, promoting constructive challenge and a focus on long-term value creation". A list of all the organisations that have committed to the Stewardship Code can now be seen on the FRC website.

The AMIC welcomes the FRC Stewardship Code and believes that the "comply or explain" principle on which the Code rests is key. Council members also hope that the Code will not be confined to the UK market. The AMIC understands that EFAMA will be producing a set of pan-European recommendations in January.

Baroness Hogg was the guest speaker at the AMIC dinner held in London in December, at which she discussed the next steps regarding the promotion of the FRC Stewardship Code. The AMIC will also be responding to the UK Government consultation on *The Long-term Focus for Corporate Britain.*

Remuneration policy: Following the publication of the CEBS guidelines on remuneration, The FSA has published its final rules for its extended Remuneration Code. The policy statement relates to CP10/19 containing the final rules to implement the amended Capital Requirements Directive (CRD) remuneration principles and will affect all firms subject to the CRD. The rules take effect from 1 January 2011, though the FSA has allowed some limited transitional provisions.

European Parliament report on corporate governance: Ashley Fox (UK MEP, Conservative) has released his report on the Commission's Green Paper for discussion in the Economic and Monetary Affairs Committee. Whilst this is not legislation and is not binding on the Commission, it will carry significant political weight in the drawing up of the Commission's proposals. The report strikes a good balance between the clear need for improving corporate governance across the EU whilst avoiding overburdening firms with excessive new rules. He also notes that corporate governance structures vary significantly across the EU and that therefore a one-size-fits-all approach would not work and could damage the competitiveness of financial institutions. "Comply or explain" should be the main approach supported by external evaluation and regulatory oversight.

Specifically the report calls for:

- creation of mandatory risk committees at board level;
- firms to establish internal systems to address conflicts between risk management and operational units, reviewed by national supervisors;
- national supervisors to develop objective fit and properness criteria;
- regular external assessments of the performance of boards;
- the roles of CEO and chairman should normally be separate unless there is a special reason to combine;
- board members should devote sufficient time to perform their duties and no individual should be on more than three boards of financial firms;
- transactions above a size set by ESMA should require shareholder approval;
- transactions involving a related party should be notified to the listing authority; again ESMA should set the benchmark.

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Valuation of illiquid assets: investors' recommendations

The AMIC has been very interested and engaged in the issue of the valuation of assets and has made some recommendations as regards the establishment and evolution of valuation policies and procedures in the context of the IOSCO consultation report on *Intermediary Internal Controls Associated with Price Verification of Structured Finance Products and Regulatory Approaches to Liquidity Risk Management.* The Council has focused on governance arrangements for the valuation of funds, particularly in the case of valuation of complex products such as ABS and structured products. Council members have been supported by KPMG in this work.

The market turmoil has led market participants to demand greater transparency and enhanced governance, specifically over the valuation and reporting of illiquid investments.

Valuation has always been key to the investment management business. Inaccurate valuation can undermine effective asset allocation for investors, as well as risk management and performance reporting for managers. It can lead to an erroneous net asset value being used as a basis for investor activities, tax reporting, secondary market transactions and fee calculations.

Over the past few years, the overall dynamics of the market crisis and specific legal issues involving inaccurate valuations have pushed investors to demand greater transparency. As the value of stocks and other publicly traded instruments has declined somewhat more than illiquid investments, some investors have found their allocation to alternative investments transformed from a relatively small part of their overall portfolios into a much larger proportion. This shift has prompted them to want a more thorough understanding of valuations of illiquid investments.

The trend toward increased investor scrutiny of valuation, combined with modifications in financial reporting standards (for example, fair value accounting requirements per FAS 157, now known as ASC Topic 820) and the passage of the US Dodd Frank legislation requiring all but the smallest alternative asset managers to register with the Securities and Exchange Commission (SEC), will mean significant changes in the ways in which fund managers carry out and support their valuations. These changes will have an impact on all facets of alternative asset managers' business models, from fundraising to back-office infrastructure. In this regard the Alternative Investment Fund Managers Directive in effect calls for a clear separation between the deal-making/front-office and valuation functions.

While market participants — investors, auditors, lawmakers and regulators — are not all likely to have identical motivations for focusing on the valuation of illiquid investments, they all look favourably upon approaches to valuation that make processes more transparent, consistent and better documented, and that provide a clear governance structure around those processes.

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AMIC events

28 October 2010: AMIC meeting with the FRC

8 November: AMIC meeting with CFA Institute

Members of the Valuation of Assets Working Group met the CFA Institute and the GIPS Secretariat to discuss the AMIC response to the IOSCO consultation report and possible areas of cooperation.

17 November: EMF conference in Brussels

Claus Nielsen, Chairman of the CBIC, made a presentation on this occasion.

1 December: AMIC meeting with IVSC

Members of the Valuation of assets Working Group met Michel Prada, Chairman of the IVSC, and other members of the IVSC Secretariat to discuss possible areas of cooperation in the future. Further meetings will be held early in 2011.

1 December: CBIC meeting with the UK authorities

In the context of the UK Review of its regulated covered bond framework, CBIC members were invited to share their views on the current framework.

2 December: AMIC meeting with the UK Treasury

The UK Treasury invited views from market participants on the latest EC credit rating agencies consultation, ahead of the consultation deadline set for 7 January 2010.

8 December: CBIC event in Paris

The CBIC organised a covered bond seminar aimed at French investors discussing the latest regulatory developments in the French obligations foncières market.

13 December: AMIC Dinner in London

Baroness Hogg, Chair of the FRC, joined us on this occasion.

14 December: AMIC meeting held at ICMA's offices in London

Hannah Gurga of the UK Treasury participated in the meeting.

17 December: Buy-side associations conference call

February 2011: Private Banking Working Group meeting in London

March: AMIC dinner and meeting in Zurich

March: Meeting between AMIC/CFA Institute/IVSC

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Regulation of the market infrastructure

Expert Group on Market Infrastructures (EGMI)

The European Commission services have set up an Expert Group on Market Infrastructures (EGMI), in which ICMA is participating as an observer. At the EGMI's inaugural meeting, as reported in the Fourth Quarter Newsletter, it was agreed that by 18 October some written input would be provided on a series of topics that may merit further attention. These papers were reviewed at the EGMI's second meeting on 25 November. The Commission intends to develop the big issues from these papers into a single document that will form the basis for a public consultation during 2011. Progress will be reviewed in the EGMI's next meeting, anticipated for 4 February.

European Market Infrastructure Regulation (EMIR)

As reported in the Fourth Quarter Newsletter, the Commission's EMIR proposal was published on 15 September. Member States undertook at the June 2010 European Council to conclude all negotiations relating to G20 commitments on financial reform by end of 2011. In line with G20 commitments, the new rules should be fully in place and operational by the end of 2012. Work in the Council has been rapidly progressed and on 7 December the Council published the latest Presidency compromise proposal, reflecting suggested amendments to the Commission draft. Following discussion of this at its 10 December meeting, the Presidency has produced a progress report summarising the main outstanding issues. The incoming Hungarian Presidency will take forward the work on this proposal.

On 30 November, the EP's Economic and Monetary Affairs Committee (ECON) held an exchange of views on the related work of its rapporteur, Werner Langen. The rapporteur broadly welcomed the Commission's proposal, which reflects many of the points made in his EP own-initiative report – adopted in June 2010. However, he also noted several issues which will now be developed in his report for the EP, which is planned to be ready by the end of January 2011. The deadline for amendments will be in February, with ECON then voting in March – clearing the way for a July Plenary vote.

Proposal for a Securities Law Directive

The Commission services have launched a public consultation to seek stakeholders' views on the harmonisation of the legal framework for securities holding and transactions. Currently, EU Member State laws on the holding and disposition of securities (such as stocks, bonds, options, futures etc) differ considerably. This fragmentation could lead to legal uncertainty in cross-border situations, for example when investors have difficulty in exercising their rights attached to securities acquired in another Member State (receipt of dividends or interest, voting, agreeing to corporate measures like stock splits, etc). Following a request by the Economic and Financial Affairs (ECOFIN) Council, the Commission will come forward with a legislative proposal before summer 2011 to increase legal certainty and efficiency of securities holding and improve protection of investors' rights, as well as address some other related aspects. The deadline for replies was 1 January 2011, though due to many requests the Commission announced that it will take into account any responses received before 21 January.

Settlement Regulation

In 2011 the Commission will propose provisions for a more formal legal framework for the carrying on of settlement activities in the EU (as this is not encompassed by the EMIR proposal). The preparations for this are under way, with the Commission having drafted discussion papers on the guiding principles of future legislation. In the Commission's view, future legislation should have two main objectives:

- to establish a common prudential framework that ensures safety and soundness of CSDs; and
- to create an enhanced framework for cross-border settlement activity in the EU.

The Commission's discussion paper raises questions for consideration under the eight broad heads of: (1) subject matter, scope and definitions; (2) authorisation; (3) supervision, oversight and cooperation; (4) access and interoperability; (5) prudential rules; (6) improving settlement discipline; (7) sanctioning regime; and (8) harmonisation of settlement periods.

Public consultation is anticipated to start in early 2011, with the target of adopting a legislative proposal in June.

TARGET2-Securities (T2S)

At the end of November a new issue of T2S OnLine was published by the ECB. In brief, this provides the following project status update:

- *Pricing:* After discussion with the market, the Governing Council has now committed to a maximum unit price of 15 € cent per DvP instruction during the period from September 2014 to December 2018. The offer is subject to the following conditions: (i) non-euro currencies will add at least 20% to the euro settlement volume; (ii) the securities settlement volume in the EU will not be more than 10% lower than the T2S Programme Office's projected volumes (which are based on market advice); and (iii) tax authorities will confirm that the Eurosystem will not be charged VAT for T2S services.
- *Network Provision:* T2S participants will interact with the T2S platform by sending and receiving messages via a network. This network service will be offered by a maximum of three external providers, selected on the basis of demanding criteria relating to security, reliability, efficiency and disaster recovery. In the last few months, much progress has been made in preparing for the tender. The selection process will be launched at the beginning of 2011 with the intention of reaching a decision by September 2011 at the latest.
- *Framework Agreement (FA):* In July 2010, the draft FA was submitted to securities regulators with a view to obtaining their preliminary feedback. In its formal response CESR expressed its strong support for T2S and provided very valuable feedback on questions – in the light of which the T2S Programme Board (T2SPB) will continue to negotiate with the CSDs in order to finalise the FA. To allow full transparency and seek the market's input, the T2SPB envisages making the FA available to the Advisory Group in early 2011. The Eurosystem intends to finalise the FA and sign it with participating CSDs in 2011, after the summer.
- *User Detailed Functional Specifications (UDFS):* The UDFS is a critical technical document of about 10,000 pages which aims to provide information to CSDs, NCBs and other T2S directly connected parties, allowing them to design and build the information systems interface required by T2S. To facilitate interaction with the relevant stakeholders and obtain their input, dedicated workshops have been, and will continue to be, held on the draft deliveries of the UDFS. An official market consultation on the UDFS will be launched in March 2011.

Besides an editorial from Jean-Michel Godeffroy, Chairman of the T2S Programme Board, and the *T2S Project Update,* the other items in this quarterly issue of T2S OnLine are:

- insight regarding the confirmed T2S pricing, by Markus Mayers (T2S Programme Office);
- interviews with Iwona Sroka and Adriana Tanasoiu (the CEOs from the CSDs of Poland and Romania respectively), in which they explain their strategies for T2S;
- a view on T2S and harmonisation, by Marc Bayle, T2S Programme Manager; and
- the introduction of the two new alternates on the T2S Programme Board.
- The Advisory Group (AG), which is an advisory body that reports directly to the ECB's decision-making bodies on the T2S project, last met on 6-7 December (and next meets on 15-16 March) for its latest progress review. A T2S info session was held on 8 October in Dublin and the next is to be in Frankfurt on 25 January.

Collateral Central Bank Management (CCBM2) project

On 8 March 2007, the Governing Council of the ECB decided to review the current Eurosystem collateral management handling procedures, in particular the Correspondent Central Banking Model (CCBM). It has decided to develop a single platform, allowing the Eurosystem to manage collateral both for domestic and cross-border operations based on the existing systems such as that of the Banque Nationale de Belgique and De Nederlandsche Bank. Work is being conducted in parallel with the T2S project in order to exploit all possible synergies and avoid any overlap.

The ECB gave related presentations on 15 September 2009 at SIBOS Hong Kong, *Drivers of Efficient Liquidity Management;* and on 27 October 2010 at SIBOS Amsterdam, *Towards a Consolidated Management of Collateral;* as well as presenting the topic at the 22 November COGESI meeting. The expectation is that CCBM2 will bring a joint collateral management system for the NCBs; technical consolidation; harmonisation; efficiency gains; and a single procedure for banks mobilising domestic and cross-border collateral. The principles guiding CCBM2's development are: central bank IT platform for the collateral management for Eurosystem credit operations, complying with the decentralised access to credit; fully compatible with T2 and T2S; domestic & cross-border, pooling & earmarking, repo and pledge; for all eligible collateral; real-time straight-through processing; and able to use all eligible Securities Settlement Systems (SSS) and eligible links between SSS.

The timeline anticipates the business requirements document in the first quarter of 2011; detailed system requirements, an interface guide and a user interface guide in the third quarter of 2011; testing in 2012; and phased migration in 2013.

Contact Group on Euro Securities Infrastructures (COGESI)

COGESI addresses issues and developments which are relevant for the euro securities settlement industry and which are of common interest for the Eurosystem, market infrastructures and market participants. The most recent meeting was in Frankfurt on 22 November. The agenda included repo clearing and settlement arrangements; CCBM2 project; New MIC (a new collateralised money market); Review of the CPSS-IOSCO standards; and settlement discipline. The next bi-annual meeting of COGESI will be in May.

Harmonisation of settlement cycles

In 2001, the Giovannini Group identified the settlement and clearing barriers to an effective single market in Europe. Barrier 6 related to the harmonisation of settlement cycles across Europe. Following on from the work of the Giovannini Group, the Commission set up the CESAME Working Group, but at the time, Barrier 6 was not a top priority. However, in 2008-2009, CESAME 2 re-examined Barrier 6 and decided it should be re-prioritised for two reasons. First, CESAME has done considerable work to harmonise corporate actions but this has brought with it a recognition that there is a need to harmonise settlement cycles. Second, the introduction of T2S will similarly require harmonisation of settlement cycles.

Therefore, CESAME 2 has set up a Working Group to consider the harmonisation of settlement cycles. At its first meeting the Working Group agreed that harmonisation of settlement cycles is critical; that the work should apply to a broader range of instruments than just equities; and that T+1 was not possible. The Working Group has subsequently looked at what needs to be done to move to T+2, noting that one of the clear benefits of T+2 would be to reduce counterparty risk. However, the implications of such a move are that it forces people to do in two days what they currently do in three or more days. Accordingly care must be taken that reduction in the settlement cycle to two days does not create a significant back office problem, particularly for buy-side and retail participants. The Working Group recognises that the working of repo markets involves certain differences and this is being taking into account.

The Working Group had a deadline of December 2010 (now slightly delayed) to develop recommendations for what needs to be done to facilitate a move to T+2. T2S will be implemented in September 2014; and a move to T+2 must be adopted before T2S.

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Electronic trade confirmations

Since 2009, the Electronic Trade Confirmation Working Group set up by the ICMA AMTE Council has worked on the improvement of the OTC confirmation process and has recently made a significant step towards its aim.

The three main objectives of the Working Group are:

- setting market practices to improve the OTC confirmation process and thus to reduce the operational risk which might arise between the trade date and the settlement date;
- obtaining for electronic matching of OTC trades a legal/regulatory status as good as faxes;
- promotion of the electronic matching as a solution to capture OTC trades into central counterparties, and thus reduce counterparty risk.

An article by Didier Bensaid on the recommendation on electronic trade confirmations follows in the box. And a link is provided to the letter, signed by René Karsenti, Chairman of the ICMA AMTE Council and President of ICMA, and Patrice Brault, Chairman of the Electronic Trade Confirmation Working Group, and submitted to the French regulator, Autorité des Marchés Financiers, in September 2010.

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Recommendation on electronic trade confirmations

The recent release of ICMA Circular No. 9, December 2010, concerning the addition of *General Recommendation 3: Trade Confirmations*, is the result of two years of collective work led by the Electronic Trade Confirmation Working Group (ETCWG). The text of the recommendation, which was approved by the ICMA Executive Committee on 6 December 2010, and became effective on 1 January 2011, states:

"Where a party has agreed with its counterparty, or is otherwise under an obligation to confirm a transaction which is subject to the Association's rules and recommendations to its counterparty in writing, it is recommended that, subject to applicable laws and regulations, such confirmation be made through the electronic system agreed between the parties to the transaction or, in the absence of a respective agreement, such other electronic means as the party who is under an obligation to confirm the transaction may choose provided the confirmation is capable of being promptly and accurately reproduced in hard copy form."

The scope of the recommendation encompasses every international security as defined in Chapter 5, Rule 2 of ICMA "Statutes, by laws, rules and recommendations", namely securities to be traded on a cross-border basis and that could be settled by an ICSD.

From the outset, the ETCWG worked on the basis of a shared assumption that a more systematic recourse by the industry to electronic means, whenever a trade has to be confirmed "in writing", would enhance the security of transactions, lower operational costs, foster straight-through-processing and allow increased settlement efficiency. Consequently, the ETCWG's efforts were initially devoted to removing obstacles in the way, and in particular legal uncertainties plaguing the use of electronic messages and platforms for trade confirmation. This drive finally ended in the conclusion that there were enough tangible and consistent elements to consider electronic trade confirmations as valid and legally binding contractual agreements under the laws of the main jurisdictions in which international market participants operate. The new addition to ICMA rules and recommendations is based on this assessment.

Recent EU draft legislation seems to point in the same direction; and the work on harmonisation of settlement cycles, which should lead to a contraction in settlement time, should provide an impulse for more automation. We believe that the initiative on electronic trade confirmations responds to an industry need and is in accordance with the evolution of the market and regulators' efforts to ensure more secure financial transactions.

Didier Bensaid
Fixed Income Business Expert
Société Générale

ICMA events

MiFID review seminars

These will continue to be run in major financial centres throughout Europe. Contact TAevents@icmagroup.org for more details.

The aftermath of the crisis: the new challenges, roundtables and cocktails, Paris, 19 January

The conference, organised by the ICMA France and Monaco region, together with trade associations representing fixed income professionals in France, is open to all ICMA members and features an opening speech by M. Christian Noyer, Governor of the Banque de France, and a concluding speech by M. Jean-Pierre Jouyet, President of the Autorité des Marchés Financiers (AMF).

There will also be roundtable discussions on the following topics: the impact of the new regulation on short term liquidity; does the expansion of the electronic trading meet with market professionals' expectations?; and indices: do they reflect or drive the market? The proceedings will be held in French and the full agenda is available from ICMA's website.

ICMA Annual Ski Weekend, Crans Montana, 21-23 January

For over 30 years, the ICMA Region of Switzerland & Liechtenstein has organised an annual ski event for ICMA member firms.

The 2011 ski weekend, which is open to ICMA's entire global membership, will be held on the weekend of 21-23 January, 2011, in the Swiss ski resort of Crans Montana.

2011 Economic Summit and New Year's Event, Brussels, 27 January

Organised by ACI, ICMA and IEDA

The conference will take place on the evening of 27 January at the Brussels Stock Exchange. It features four guest speakers – Pascal Paepen, Daiwa Capital Markets; Natacha Valla, Goldman Sachs; Gianluca Salford, J.P. Morgan Chase; and Stephane Deo, UBS – all economists from financial institutions, who will give their brief outlook for exchange rates and the bond and equity markets for 2011, followed by a panel discussion. The moderator will be Peter Vandenhoute, Chief Economist at ING. The summit will be followed by a buffet dinner.

Attendance at the summit is free of charge; please register by e-mail to icmabelgium@icmagroup.org.

Update on Regulatory Reforms for the Capital Market, Copenhagen, 4 February

Organised by Nordic Capital Markets Forum and ICMA, hosted by Nordea Bank.

The seminar will provide an overview of the key ongoing developments in the regulation of capital markets activities and will focus on the recent and forthcoming changes through the PD, MAD, MiFID and the Short-Selling Regulation.

ICMA European Repo Council (ERC) General Meeting, London, 10 March

The 2011 European Repo Council (ERC) General Meeting is to be held in London on the morning of 10 March. We are pleased to announce that J.P. Morgan will once again host this event, which will be followed by its annual Securities Financing and Collateral Management Conference. The conference provides in-depth insight on the latest industry and regulatory developments and trends whilst also providing an opportunity to network.

Understanding the IPMA Handbook (ICMA Primary Market Handbook) London

Course dates for 2011: 3 March, 9 June, 8 September and 8 December

This half-day workshop will give an overview of the scope and application of the recommendations within ICMA's Primary Market Handbook for the issuance of international debt and debt related instruments and will also review recent developments and changes.

Contact: ICMA Events
taeventsteam@icmagroup.org

Save the date - ICMA AGM and Conference, Paris, 25 to 27 May 2011

The venue for the 2011 Paris meeting will be the Marriott Rive Gauche Hotel. There are a number of sponsorship and exhibition opportunities available at varying levels.

The 2011 programme is in development, ICMA members are invited to become involved by suggesting themes and speakers.

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20th ICMA ERC European Repo Market Survey

There is still time to participate in the ICMA European Repo Council 20th semi-annual survey of the European repo market. The survey which has run since 2000 is now the established source of information on the European repo market – widely consulted by the industry and its regulators. We anticipate that the 20th survey will offer unique insights into the continuing sovereign debt crisis and longer-term trends.

The credibility of the survey depends on continued broad participation by the market and any institutions doing repo business in Europe are invited to submit a return for the amount of business outstanding on Wednesday, 8 December 2010. Participation in the survey offers direct benefits; survey participants are given the rankings of their firms in various categories of business and have access to the survey director at the ICMA Centre at Reading University. We publish only the aggregate of all survey returns and that each institution's return is subject to the strictest confidentiality.

The questionnaires for the survey can be accessed from the ICMA website.

Contact: reposurvey@icmagroup.org

Summary of forthcoming ICMA Executive Education courses

Introductory programmes

Financial Markets Foundation Course (FMFC)
28 February-2 March, Luxembourg
7-9 March, Copenhagen
11-13 April, London
19-21 September, London
26-28 September, Luxembourg

Securities Operations Foundation Course (SOFC)
16-18 March, London
11-13 October, London

Intermediate programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Residential courses:
1-7 May, Sitges, Barcelona
21-27 August, Seoul, South Korea
16-22 October, Sitges, Barcelona

Operations Certificate Programme (OCP)
27 March – 2 April, Brussels

Primary Market Certificate (PMC)
16-20 May, London
14-18 November, London

Specialist programmes

Commodities - An Introduction
24 February, London

Commodities - Trading and Investment Strategies
25 February, London

Credit Default Swaps (CDS) - An Introduction
10 March, London

Credit Default Swaps (CDS) - Operations
11 March, London

ICMA welcomes feedback and comments on the issues raised in the Regulatory Policy Newsletter.

Please e-mail:
regulatorypolicynews@icmagroup.org
or alternatively the ICMA contact whose e-mail address is given at the end of the relevant article.

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