

Regulatory Policy Newsletter

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Repo – a lifeline

Foreword by Godfried De Vidts, Chairman of the ICMA European Repo Council

Recent events in the European government bond market have spawned a number of articles in the financial press that evidence a fundamental lack of understanding of the basis of modern day financing of the wholesale markets.

Prior to Basel II, lending between wholesale banks was largely unsecured, exposing each bank to 100% counterparty risk. The capital accord as adopted in the European market helped the development of the repo market; secured lending was encouraged with recommendations of specific haircuts (additional security for the lender), specifically for non-government bonds.

Central banks have endorsed repo as a tool to provide oxygen to the banking sector, enabling them to regulate the amount of liquidity in circulation. Both the implementation of central banks' monetary policy and the provision of daily liquidity to provide payment capacity to the banking sector are executed against collateral.

The European repo markets, under the guidance of a group of annually elected professionals from the industry, meet regularly in what is now widely known as the ICMA European Repo Council, which has guided the development of a collateralised market well ahead of the G20's 2008 call for centralised clearing to mitigate counterparty credit risk.

In recent years, LTCM, the Russian crisis, the dot.com collapse and more recently the Lehman crisis have shown that repo is a reliable and robust way to keep liquidity flowing in highly disruptive market conditions. It allows protection of the cash lender through the use of collateral of a wide variety of origin including not only government or corporate bond issues, but also ABS/MBS securitisation issues and bank loans (generally known as credit claims). The recent downgrading of some European sovereigns has impacted the appetite of bond purchasers. Some markets are less liquid but, through a combination of the Eurosystem financing tools and the ability of the repo markets to exchange all types of collateral in basket trading through CCPs, no disruption has been seen in the repo market.



Godfried De Vidts

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On the contrary, volumes remain very healthy as evidenced in the 21st semi-annual repo survey published on 14 September. The use of centralised clearing, currently standing above 30% of total repo business, demonstrates the ability of the repo markets to establish a robust framework.

The forthcoming Basel III capital accord (CRD IV in Europe) is already starting to impact how repo markets are structured. The creation of liquidity buffer requirements for banks has lengthened the maturity of outstanding repo transactions. The current uses of General Collateral baskets have also changed, as some sovereigns have been downgraded making the use of such bond issues unpalatable for daily interbank financing transactions. For now the Eurosystem is the only location where such bonds are still readily acceptable. Basket trading exists, either for pure government bond collateral or using the Eurosystem's eligible bond criteria, as a mechanism allowing CCPs to provide financing from the cash lender without having counterparty risk. The ERC is consulting within the industry regarding what the most appropriate composition of these baskets should be.

Market participants have seen some return to national market practices that have a tendency to harm a European wide liquidity framework. The recent ICMA ERC study on the interconnectivity of central and commercial bank money in the clearing and settlement of the European repo market has clearly shown the need for further improvements.

The ERC's current priorities to facilitate adequate European wide financing are:

- development of interoperability for triparty between both ICSDs;
- access by all types of trading venues to all CCPs irrespective of the location of collateral; and
- improved European-wide access to liquidity, fully respecting the level playing field for all.

There is an important role for the industry in delivering these goals. But there is an equally important role for governments, regulators and the European Commission. Legislative initiatives from the European Commission currently on the table need to be adopted and implemented. If Europe's politicians are serious in their goal to create a European capital market that will benefit Europe's citizens, they have to show political courage and put aside national interests for the wider benefit of all. The current European government bond crisis has illustrated that nobody is immune to liquidity issues. The post-trade framework for moving collateral in optimal circumstances to where it is best and most economically usable is crucial. Some additional reforms for the repo market itself may be needed but policy makers should take care not to harm the many achievements that have allowed this market to deliver the flow of liquidity for the benefit of the real economy.

Current calls by the FSB to look at the repo market as being part of the shadow banking industry are unwelcome. The ERC has educated many on the topic of secured financing, engaging with policy makers and central banks on a continuous basis and it will continue this work to widen the understanding of the usefulness of the product to both governments and the real economy. There is no easy way out of today's crisis and everybody will have to share the burden. But damaging the product that has played such a crucial role in the provision of liquidity in difficult situations to sovereign and private issuers will only aggravate the crisis, which is something we can ill afford.

Godfried De Vidts
Chairman, ICMA European Repo Council

Message from the Chief Executive



Martin Scheck

The capital markets continue to display extreme volatility, reacting violently to changes in sentiment, and their efficient functioning has been severely compromised during the current crisis. Whilst solutions to the current situation are largely in the hands of politicians, as the crisis has developed we have seen various market practices and procedures becoming increasingly stressed, in a number of different market segments affecting ICMA members.

In order to act effectively it is vital that ICMA is aware of these market developments as they arise. We are alerted to many of these situations by market experts participating in the various ICMA committees and councils, from information furnished by our board members, and also from the important ICMA regional committees

who are our “eyes and ears” in the regions. Once we have the input typically we can react quickly to analyse the situation and decide on the next steps. This was the case recently where information from our members relating to an escalation in settlement fails led us to set up a working group within a very short time frame to analyse what we may be able to do in order to alleviate the problem.

Particularly in these challenging times, information is key and speed of action is of the essence. Our existing committee and board structures work well in providing input – but we would like to encourage all of you proactively to let us know whenever you see an issue which you think we can potentially help with. You are very welcome to call me or any one of my colleagues directly, or alternatively you can reach us on the following mail address – info@icmagroup.org.

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Sovereign risk in the European capital market

Introduction

One of the main concerns in the international capital market over the past quarter has been the prospect of lower economic growth and the risk of a return to recession in the US and in Europe. This has been a particular concern in the market because of the high levels of public and private sector debt left over from the international financial crisis which began in 2007, coupled with the continuing fragility of the banking system. The result has been a substantial fall in equity markets, particularly bank shares, accompanied by a further reduction – to historically very low levels – in the yields on benchmark sovereign bonds, particularly US Treasuries, UK gilts and German bunds.

While yields on bunds have fallen, yield differentials between bunds and some other euro area sovereign bonds have widened to levels unprecedented since the introduction of

the euro in 1999. For a time after the introduction of the euro, sovereign risks in the euro area were regarded in the market as virtually indistinguishable; yield differentials were minimal; and the main risk for investors appeared to be limited to changes in interest rates. But since the international financial crisis began, the position has changed: credit risk has also become an important factor. Sovereign bond yields and CDS spreads have risen to unsustainable levels in Greece, Portugal and Ireland (though yields in Ireland have recently fallen somewhat). There have also been substantial rises in sovereign bond yields and CDS spreads in Italy and Spain (Chart 1).

This Quarterly Assessment considers why there has been a sovereign debt problem in parts of the euro area; what steps the euro area authorities are taking to resolve it; and what questions remain (as at the end of September) to be resolved. The focus is on the technical issues involved, while recognising that the ultimate decisions to be taken are political, and depend on popular support. Resolving the sovereign debt problem in the euro area in a timely way is critical to restoring an efficiently functioning international capital market in Europe.

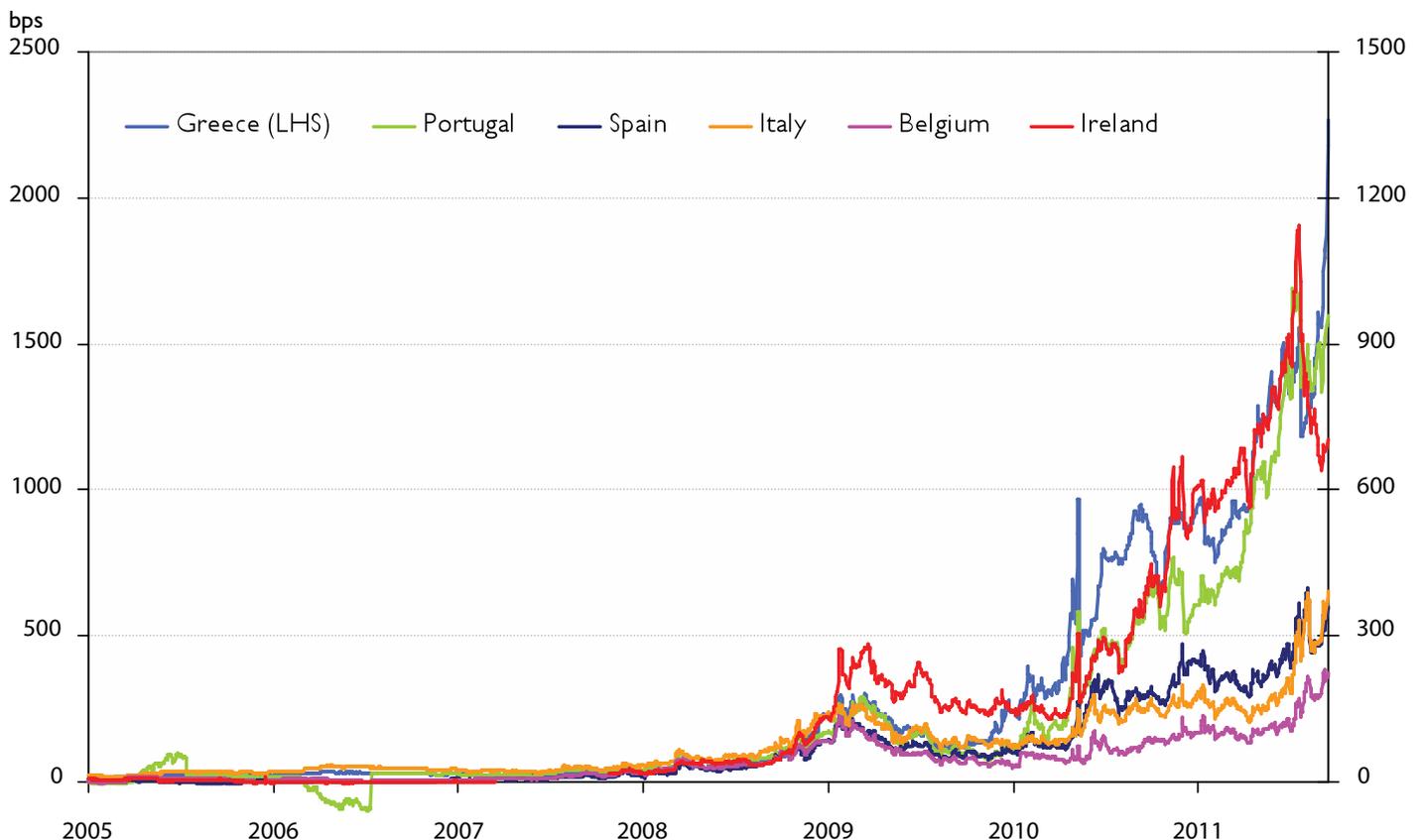


Chart 1: Euro area sovereign bond spreads. Source: Bloomberg

Why has there been a problem in the euro area?

The problem can be summarised as follows:

- Monetary union in the euro area has not been accompanied by a full fiscal union, but by the Stability and Growth Pact (SGP). Under the SGP, governments originally undertook to limit their budget deficits to 3% of GDP. But a significant number of governments have not kept within the SGP, for at least the last seven years, and the SGP has not to date been enforced. Since the beginning of the international financial crisis in 2007, budget deficits have risen substantially, raising levels of government debt and debt service. There is also concern in the market about the extent to which debtor governments will have the capacity to repay their debt out of future economic growth, given the recent deterioration in economic prospects.
- In the euro area, individual governments not only do not issue their own currency but they do not currently stand behind each other's debts. As a result, though the overall budget deficit and the overall government debt of the euro area are lower – as a proportion of GDP – than those of the US or Japan, the market does not currently assess the budget deficit and the government debt of the euro area as a single entity. It assesses the budget deficit and debt of each individual government within the euro area (Chart 2). As budget deficits have increased, there has been a growing concern in the market that sovereign debt in the euro area may not be risk-free, and the market has priced in a risk of default, at least in the case of Greece. Concerns in the market have grown since the Franco-German Summit in Deauville in October 2010. In response, yields on government debt in some peripheral euro area countries have risen to – or near to – unsustainable levels,

their ratings have been downgraded and their access to the international capital market for financing has been impaired or completely cut off.

- The sovereigns and their banks are interdependent, because the banks need to own large holdings of government debt (eg for liquidity purposes). Where government debt yields have risen, market values have fallen, giving rise to potential losses for the banks and in some cases the need for more capital. This is at a time when the banks' capital positions have in many cases not fully recovered from the consequences of the Lehman default in 2008. In those cases in which there is market concern about insufficient bank capital, bank liquidity has also become more difficult to obtain in the wholesale markets. To prevent withdrawals of wholesale deposits from the banks as the cost of government funding has risen, the cost of bank funding – and bank CDS spreads – have also risen. Even in countries where the level of public sector debt is comparatively low, the market is concerned about the risk of bank losses if the level of private sector debt is comparatively high.
- Financial stability in the euro area and beyond is at risk from contagion from one debtor government to another, and from one bank to another. This problem is amplified by the interdependence and high level of financial integration across borders in the euro area.
- Finally, there are constraints on the support that creditor governments can provide to debtor governments in the euro area as a result of the “no bail-out” clause in the EU Treaty. The Treaty can only be changed with the agreement of all 27 Member States, some of whom would require a popular vote in a referendum. And in some Member States, national law is embedded in the constitution, and can only be changed by a popular vote.

% of GDP 2011

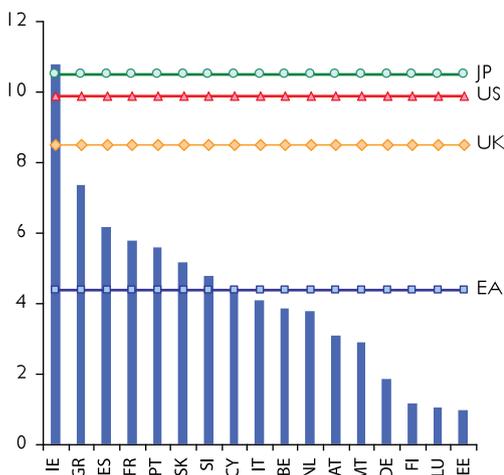
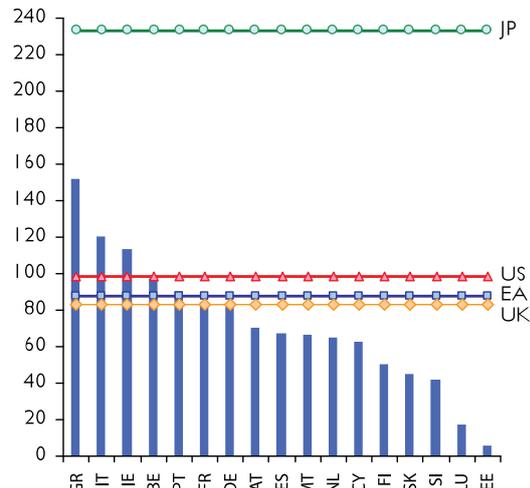


Chart 2: Government deficits (LHS) and debt (RHS). Source: IMF, ECB

% of GDP 2011



How are the euro area authorities attempting to solve it?

The next question is what steps the authorities in the euro area are taking in an attempt to solve the problem, within the EU Treaty.

First of all, sovereign creditors (particularly Germany) have stressed the importance of budget discipline and “austerity”, where necessary, among sovereign debtors. This approach puts the emphasis on debtor governments being self-reliant and taking their own fiscal steps at national level to keep their budget deficits and government debt at a sustainable level.

Second, where budget discipline on its own is not sufficient, at least in the short term, bail-outs have been provided, mainly by the European Financial Stability Facility (EFSF) and the IMF, for Greece, Ireland and Portugal, and a second bail-out has been proposed for Greece. In each case, policy conditions have been imposed on the debtor governments in exchange. Changes have been proposed to reduce the interest cost and extend the maturity of bail-out loans and to increase the availability of funds within the existing EFSF ceiling (of €440 billion). The EFSF, which is temporary, is due to become the (permanent) European Stability Mechanism (ESM) in July 2013.

Third, under its Securities Market Programme, the ECB has intervened in the secondary market to buy government securities in an attempt to keep markets functioning and prevent their yields from rising to an unsustainable level: initially in Greece, Ireland and Portugal, but recently also in Spain and Italy. Unlike primary market intervention, which is ruled out by the EU Treaty, the ECB considers that secondary market intervention is permitted by the Treaty; and unlike quantitative easing, ECB intervention is currently sterilised. However, ECB intervention is intended to be only a temporary “bridge” – the ECB’s role may be taken over by the EFSF – and ECB intervention is also conditional on policy steps being taken by the debtor governments concerned.

Fourth, the ECB has offered to continue to provide unlimited short term liquidity to banks in the euro area, including those that are not able to obtain liquidity in the market, and has eased the terms on which it is willing to accept collateral (though it is not able to accept sovereign debt in default). In addition, the ECB, Federal Reserve, Bank of England, Swiss National Bank and Bank of Japan have recently announced that they will provide US dollar funding over the year end.

Fifth, the main European banks have been stress-tested and are due to be re-tested – against stricter conditions than before – to check whether they have adequate liquidity and they need extra capital. If losses prove to be greater than the stress tests originally assumed, and extra bank capital is needed which the banks are not able to raise in the market themselves, either their host governments are expected to provide it if they can, or the EFSF could do so, once its new powers have been approved. If a bank is at risk of insolvency, it can either be taken over or become subject to a resolution regime.

Sixth, the ECB also has the option to reverse recent rises in short-term interest rates, if it considers that a more accommodating monetary policy is consistent with controlling inflation across the euro area as a whole.

Seventh, as a condition for the second Greek bail-out, the private sector has been involved for the first time. It is planned that private sector involvement should take the form of “voluntary refinancing” (which is intended not to trigger a credit event under CDS). But the credit rating agencies are expected in the market to treat it as a selective default, at least for a short period of time, as it currently involves a 21% reduction in the net present value of affected bonds compared with the original terms. It is not yet clear whether this plan will need to be revised.

Finally, in the longer term, collective action clauses (CACs) are due to become mandatory from July 2013 in all euro area sovereign bonds, auctioned as well as syndicated, under national law as well as foreign law. CACs are designed to make debt restructuring easier to organise, though if a CAC were to be used this might trigger a credit event, which the euro area authorities have so far been keen to avoid.

What are the remaining questions to resolve?

The steps that have so far been taken by the euro area authorities have left the market with a series of questions which have not yet been definitively resolved. Market confidence has been damaged by uncertainty arising from differences of view between creditor and debtor governments in the euro area, and between some governments and the ECB, about what should be done; and in particular about whether, when and on what basis, the euro area should become more integrated, or whether there is a risk that it will fragment.

Timing

First, the market is concerned about the time needed for euro area governments to take decisions and to implement them. The ECB can take and implement decisions within its remit quickly, if the Governing Council agrees (though there have been disagreements about the scope of its remit, for example, on secondary market purchases). But it is taking a much longer time for the 17 governments in the euro area to ratify their agreement of 21 July on the second Greek bail-out and to increase the effective size and scope of the EFSF. It is also important to note that the German Constitutional Court has ruled that any future bail-outs or related measures should be approved by the Bundestag.

Financial support

Second, the market is unclear whether official support for bail-outs is limited or unlimited. On the one hand, governments in the euro area have repeatedly said that they will take whatever steps are needed to safeguard the financial stability of the euro area. On the other hand, there are strict financial limits on the steps that they have so far agreed to take in practice:

- ECB intervention is intended to be temporary (though the size of the ECB's outright holdings of securities is still much smaller than the Federal Reserve); and the size of the EFSF is currently limited to €440 billion, which would not be sufficient to bail out any large sovereign debtor in the euro area, if needed.
- There has so far been reluctance among sovereign creditors to increase the size of the EFSF (beyond €440 billion). Leveraging the EFSF so that its capital contribution could provide four or five times as much finance – ie by turning the EFSF into the equivalent of a European Monetary Fund which acts as a bank or guarantor or first loss insurer (eg to make ECB intervention less risky) – has been suggested as a way of increasing the scale of financial support potentially available, but discussions are at a preliminary stage. If the EFSF is increased further in size, there is a question whether parliamentary approval should, and would, be obtained.

Conditionality

Third, while policy conditions have been imposed on debtor governments in the euro area in exchange for financial support, the market is not clear how these conditions are to be enforced, in the absence of full fiscal union.

- Full fiscal union would involve central euro area control over national budget deficits, and ultimately over national taxation and public expenditure in individual countries in the euro area. As taxation is currently the responsibility of national parliaments, fiscal union would create a “democratic deficit”, and require a change in the EU Treaty.
- Under full fiscal union, individual euro area governments might be financed by the issue of “eurobonds” with joint and several liability being borne by all 17 euro area governments (unlike the financing of the EFSF). The European Commission is due this autumn to put forward options for the issue of eurobonds. Proponents argue that eurobonds would make it easier for debtor governments to access the market at lower rates. Critics argue that eurobonds would increase rates for creditor governments; that the provision of guarantees might affect their credit ratings; and that budgetary discipline on debtor governments would be reduced. Depending on the structure proposed, the issue of eurobonds might also require a Treaty change.

Any Treaty change would take a considerable time to implement and could be difficult to deliver in current circumstances. (The previous EU Treaty was initially voted down in France and the Netherlands in 2005). An EU Treaty change would require the agreement of EU Member States (such as the UK) which do not participate in the euro area. If a euro area Treaty was proposed instead, this would break new constitutional ground in the EU. Whichever approach was adopted, fiscal union in the euro area would have wider implications for the EU. For example, what would be the role of the European Commission and the European Parliament in the governance of the euro area? Would qualified majority voting need to change, otherwise – if the euro area voted as a bloc – it would generally be able to secure a qualified majority in the EU? And what would be the implications for the Single Market?

In the absence of a Treaty change on fiscal union, can budgetary discipline in the euro area be enforced?

- While it has not proved practicable to enforce the SGP so far, it has now been proposed that national governments should make constitutional changes to include national budgetary limits as “debt brakes”. Will this make the SGP easier to enforce in future?
- Policy conditions have been set in exchange for bail-out funding from the EFSF and IMF, and for ECB intervention. Should the ECB set policy conditions independently, or should euro area governments set them?
- What happens if debtors persistently fail to meet the conditions set? In the first instance, new money might not be provided, and sanctions (discretionary or automatic) might be imposed. But there would be a risk of moral hazard, if creditor governments were to be subject to pressure to continue to support debtors, who might otherwise threaten to leave the euro area. The Dutch Government has recently proposed that a possible way of solving this problem would be to allow a debtor government to leave the euro area, if it persistently fails to meet the budgetary policy conditions set.

Costs

Fourth, it is not yet clear where the costs arising from the crisis, and in particular any losses, should fall. In the case of an official bail-out, costs fall on taxpayers. But a condition for bail-outs may be the restructuring of debts to the private sector, as a result of which losses will fall initially on creditors, though – if the losses are sufficiently severe to make banks insolvent – there is a question about whether the banks involved will in turn be bailed out by taxpayers. An EU or euro area financial transactions tax is being proposed by the French and German Governments as an additional source of revenue from financial institutions.

It is also not clear whether the private sector involvement proposed in the second Greek bail-out is to be treated as an exception or a model. It has so far been treated as a one-off case. But it may still provide a precedent for further restructuring in future: either in the Greek case, if the private sector involvement so far is not regarded as sufficient to make the fiscal position in Greece sustainable; or in other debtor countries, if restructuring is deemed to be necessary.

Competitiveness

Fifth, there is a longer term question about how growth can resume in debtor countries if their economies are uncompetitive, as in the case of Greece. Stronger growth in creditor countries should help debtor countries too. It may also be possible for a debtor country to regain competitiveness by successfully implementing structural reforms (as hoped in Ireland). But in many programmes in which the IMF is involved in lending to debtor countries in other parts of the world, competitiveness is restored relatively quickly only with the help of debt restructuring and exchange rate devaluation.

In the case of Greece, debt restructuring has so far been limited to “voluntary refinancing”, and exchange rate devaluation is not possible within a monetary union:

- It is widely thought in the market that debt restructuring in Greece would have to be more extensive than the “voluntary refinancing” proposed to date in order to reduce Greek Government debt to a sustainable level. But if a restructuring took place which involved writing down Greek debt by a larger amount, a more substantial bank recapitalisation would also be required (than proposed as a result of the July stress tests); and a financial “firewall” might be needed around the rest of the euro area to prevent contagion.
- Exchange rate devaluation is not possible within a monetary union. The commitment of euro area governments to the euro is intended to be irrevocable. Consequently, devaluation by means of an exit from the euro area involving the replacement of the euro by a new national currency – as opposed to depreciation of the euro against third currencies like the US dollar – is not officially permitted. If an exit from the euro area were still to occur, it would not be straightforward to implement in practice. First of all, there is a risk that the market would anticipate such an exit by withdrawing funds from the banking system: capital controls might be needed, at least for a time; and banks might need to be recapitalised. And after exit, it is unclear how existing financial contracts would be treated: whether, for example, contracts under national law would be redenominated in the new national currency, while contracts under foreign law would remain denominated in euro. But whatever form exit from the euro area took, the result would be the introduction of a new currency – or new currencies – in place of, and in parallel with, the euro.

Wider implications

Finally, the need to resolve the sovereign debt crisis in the euro area has wider implications for the global economy, and in particular for other European countries outside the euro area, whether they are in the EU or not. For example, the economic recovery in countries like the UK will be affected by the outcome, even though the UK is not a member of the euro area; and Switzerland, which is not a member of the EU, has chosen to peg the Swiss franc to the euro in an attempt to prevent its rise in response to the sovereign debt crisis in the euro area.

Conclusion

This Quarterly Assessment has considered why there has been a sovereign debt problem in parts of the euro area; what steps the euro area authorities are taking to resolve it; and what questions remain (as at the end of September) to be resolved. The questions relating to the creditworthiness of sovereigns and the questions relating to the capital and liquidity of banks are closely linked, and need to be addressed together. While the market is seeking an immediate solution which restores confidence, some issues can only be resolved through a change in the EU Treaty, which would take time. In addition, the way in which the problem is resolved has much wider implications, both inside and outside the euro area.

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Recent practical initiatives by ICMA

Sovereign bond markets

1. ICMA has submitted a detailed response to the consultation by the European authorities on collective action clauses in euro area sovereign bonds, with *pro bono* assistance from Clifford Chance.
2. ICMA has organised with AFME a briefing call for members on the sovereign debt crisis in the euro area, with economics experts from Barclays Capital and Nomura.

Short-term markets

3. The ICMA European Repo Committee has submitted comments to the Financial Stability Board on repo aspects of its consultation on *Effective Resolution of Systemically Important Financial Institutions*.
4. The ICMA European Repo Committee and the ERC Operations Group have written to Monte Titoli regarding its recent system outage, asking for improved communication with the market and seeking reassurance about the robustness of improvements in the system to prevent a recurrence.
5. The ICMA European Repo Committee has written to LCH.Clearnet SA asking for clarification of the calculation of the reinvestment period relating to the coupon on a bond being used as collateral in a buy/sell-back transaction. LCH.Clearnet SA has amended its algorithm.
6. The ICMA European Repo Committee has published a recommendation on repo matching as a driver for risk reduction.

Primary markets

7. An explanatory note on *New Issue Processes* is published in this edition of the *ICMA Quarterly Newsletter*.
8. ICMA has responded on bail-ins to the Financial Stability Board's consultation on *Effective Resolution of Systemically Important Financial Institutions*.
9. ICMA has responded to ESMA's consultation on its technical advice to the European Commission on Level 2 of the review of the EU Prospectus Directive.
10. ICMA has responded to HM Treasury's consultation on *The New UK Approach to Financial Regulation*, focusing on the role of the UK Listing Authority.
11. Following the Usage Review, we are continuing to revise the ICMA Primary Market Handbook. The work is being overseen by the ICMA Legal & Documentation Committee.

Secondary markets

12. Following a members' roundtable, we are developing proposals to strengthen our Secondary Market Rules and Recommendations in the key area of settlement discipline, given the recent increase in market concern about settlement fails.

13. We are continuing to coordinate closely with other trade associations, including AFME, ISDA and the FOA in London and ICSA members in continental Europe, on the European Commission's MiFID review. Legislative proposals are currently expected from the Commission in the late autumn.

Asset management

14. The ICMA Asset Management and Investors Council (AMIC) has responded to the European Commission Green Paper on a *European Corporate Governance Framework*.
15. The ICMA Covered Bond Investor Council (CBIC) has responded to HM Treasury on the review of the UK's regulatory framework of covered bonds.
16. The CBIC has consulted on proposals for the transparency of all covered bond issuance on a national basis with the objective of producing a widely agreed standard for issuers later this year.
17. The AMIC ETF Working Group has published a report on *Exchange-Traded Funds*, which complements AMIC's response to ESMA's discussion paper on the subject.
18. With the agreement of the AMIC Chairman, proposals for a new AMIC structure based on three pillars – twice yearly conferences of the Council involving both ICMA members and non-members; regular meetings of an Executive Committee consisting of full ICMA members, but which can also call on outside experts; and Working Groups – are due to be decided at the AMIC meeting in London in December.

Market infrastructure

19. The ICMA European Repo Committee has submitted comments to the Committee on Payment and Settlement Systems and the Technical Committee of IOSCO on their consultation paper on *Principles for Financial Market Infrastructures*.
20. The ICMA European Repo Committee has launched a report on the workings of the payment infrastructure underlying the settlement of securities transactions in Europe, including repo transactions. The report highlights the essential interplay between central bank and commercial bank money in securities settlement.

Other engagement with regulators

21. With our members, we have also held meetings with senior representatives of the ECB, ESMA, European Commission officials, the Bank of England, HM Treasury, the Deutsche Bundesbank, the Banque de France, and a number of national regulators.

G20 financial regulatory reforms

Ahead of its 18 July plenary meeting the FSB made available an [Implementation Progress Report](#) on *The Financial Crisis and Information Gaps* prepared by IMF staff and the FSB secretariat.

Since the last progress report a year ago, consultations with national authorities revealed broad agreement with, and a positive view of, the G20 Data Gaps Initiative, with better identification of the build-up of risks in the financial sector and financial interconnectedness (domestic and cross-border) being among the highest priorities. Work in the priority areas is progressing well; data availability is also increasing; and conceptual work is also progressing. But important challenges remain:

- efforts to further strengthen the availability of consistent and comparable economic and financial data remain important;
- ensuring adequate resourcing of statistical work; and limiting the reporting burden on the private sector, national, and international authorities; and
- ensuring appropriate access to data as macroprudential analysis needs more granular data than has been required for macroeconomic analysis. Legal frameworks for data sharing and for data collection may need to be reviewed in some instances.

The report seeks endorsement by the G20 Finance Ministers and Central Bank Governors of action plans and timetables.

As announced in its [summary press release](#), the FSB met in Paris on 18 July. The meeting reviewed the draft consultation papers to be published following the meeting on measures to address the risks posed by global systemically important financial institutions (G-SIFIs). Members also assessed vulnerabilities affecting the financial system and the progress of initiatives in a variety of policy areas – including shadow banking; OTC derivatives reform; market integrity; and accounting convergence – to address them. The meeting also approved the finalised arrangements for the establishment of Regional Consultative Groups to broaden the range of countries involved in the FSB's work.

On 19 July the FSB and the Basel Committee on Banking Supervision (BCBS) [launched a public consultation](#) on two documents that set out proposed measures to address the systemic and moral hazard risks posed by systemically important financial institutions (SIFIs). The measures implement the framework contained in the FSB's recommendations endorsed by the G20 Leaders in November 2010.

- The FSB consultative document on [Effective Resolution of Systemically Important Financial Institutions](#) is further described in the crisis management segment of this Newsletter.
- [Released by the BCBS](#), the second consultative document on [Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement](#) sets out a methodology for assessing the global systemic importance of banks, the magnitude of added loss absorbency that globally systemic banks should have, and the proposed arrangements by which these requirements will be phased in. The assessment methodology for global systemically important banks is based on an indicator-based approach and comprises five broad categories: size, interconnectedness, lack of substitutability, global (cross-jurisdictional) activity and complexity. Responses to this FSB consultation document were requested by 26 August.

The FSB, in cooperation with the international standard setting bodies, will carry out further work to address global systemically important insurers, domestic systemically important banks, other systemic financial firms and financial market infrastructure.

The final recommendations will be submitted to the G20 Leaders Summit in Cannes on 3-4 November.

As reported in its [press release dated 1 September](#) the FSB is progressing its work on shadow banking. Its task force has conducted a further data and information sharing exercise during the summer as a step toward evaluating and adjusting the proposed framework. This could lay the basis for data collection and assessment by the FSB of global trends and risks in shadow banking from 2012 onwards.

The task force has also developed general principles for designing and implementing regulatory measures; and has conducted a regulatory mapping exercise to take stock of existing national and international initiatives on the four broad categories of possible regulatory measures set out in the [FSB's April background note](#). As a result of this, the task force has identified five areas where more detailed work is warranted to help gauge the case for further regulatory action:

- (i) the regulation of banks' interactions with shadow banking entities (indirect regulation);
- (ii) the regulatory reform of money market funds (MMFs);
- (iii) the regulation of other shadow banking entities;
- (iv) the regulation of securitisation; and
- (v) the regulation of activities related to securities lending/repos.

In order to make progress, the FSB has decided to set up dedicated workstreams to focus on each of these areas. The workstreams will develop preliminary work plans shortly, and report their progress as well as the proposed policy recommendations to the FSB by July 2012 (or end-2012 for securities lending/repos). The FSB will elaborate on the recommendations for strengthening the oversight and regulation of shadow banking in a report for the G20 in October.

On 24 September Mario Draghi, Chairman of the Financial Stability Board, made a [statement to the IMFC](#) (International Monetary and Financial Committee) on the occasion of its [24th meeting](#) in Washington ([other statements made](#) at this meeting are also available). Whilst describing some of the key elements of the FSB's work programme, Mario Draghi covered:

- *Addressing systemically important financial institutions (SIFIs)*: The FSB's initiative comprises action in five areas: improvements to resolution regimes; requirements for additional loss absorption capacity; more supervisory oversight; more robust core FMI; and peer reviews. The FSB is finalising policy recommendations in the first two of these areas, for delivery to the Cannes G20 Summit. In addition, the FSB will publish a report in November on the progress being made to address the intensity and effectiveness of supervision.

- *Shadow banking*: Work is underway, in collaboration with standard-setters, to gauge the case for further regulatory action in five areas: regulating banks' interactions with shadow banks; regulatory reform of MMFs; regulation of other shadow banks; regulation of securitisation; and regulation of securities lending/repo activities. The FSB will publish a report on this subject in October.
- *Implementation monitoring*: The FSB has already been reporting regularly since 2008 on progress in the development and implementation of reforms and will intensify this through the establishment of a Coordination Framework for Implementation Monitoring, drawing on monitoring undertaken by individual standard setters as well as by the FSB. Priority areas will include the implementation of Basel III capital and liquidity standards; and the reform of the OTC derivatives market.

As announced in its [28 September press release](#), the BCBS has agreed on a range of measures to finalise key elements of its policy agenda and to put in place a strong implementation assessment framework.

- The BCBS agreed to finalise the assessment methodology for global systemically important banks (G-SIBs). It agreed to retain the proposed calibration for the additional loss absorbency requirement, which will range from 1% to 2.5% Common Equity Tier 1 (CET1). The BCBS is proposing some changes to certain indicators to improve the methodology for identifying G-SIBs, which will be subject to additional testing by March 2012. The BCBS will issue the revised G-SIB rules text before the November meeting of the G20 Leaders. It will continue to improve the quality and transparency of the data underlying the assessment methodology in time for implementation by 1 January 2016.
- The BCBS discussed comments on its proposal to introduce capital requirements for banks' exposures to CCPs. It agreed to a number of adjustments to the treatment of banks' exposures to a CCP default fund and will issue these changes for final consultation in the coming weeks.

- The BCBS also reviewed its work to finalise the liquidity standards over the observation period. While the observation period for the Liquidity Coverage Ratio (LCR) extends until mid-2013, the BCBS agreed to accelerate its review to arrive at any adjustments in key areas well in advance of the mid-2013 deadline. This accelerated process should provide greater market certainty about the final technical details and calibration of the LCR. The BCBS continues its work to evaluate the Net Stable Funding Ratio (NSFR) over the observation period.
- Finally, the BCBS put in place a rigorous framework to monitor and review its members' implementation of the Basel regulatory capital framework, which will be coordinated by the BCBS's Standards Implementation Group and will rely on peer reviews.

On 13 July the [Joint Forum released a report](#) on securitisation incentives. This report analyses the incentives to engage in securitisation throughout the market before the financial crisis, the distortions created by misalignments and conflicts of interest which emerged, and the interplay of incentives in the aftermath of the crisis. It also examines some of the reasons why there has yet to be a meaningful recovery in securitisation activity. The report outlines three recommendations to authorities on the tools and approaches they can employ to promote a sustainable and responsible securitisation framework. These specify that:

- authorities should employ a broad suite of tools to address misaligned incentives, which may include measures to improve loan origination standards, and to align compensation arrangements with long-term performance and asset quality;
- authorities should encourage markets to improve transparency to ensure that investors, other market participants, and supervisors have access to relevant and reliable information; and
- authorities should encourage greater document standardisation and less product complexity, which should assist in reducing information asymmetries and stimulating liquidity in secondary securitisation markets.

On 3 October the FSB held a plenary meeting in Zurich, following which there was a press release [reporting on the discussions](#). The FSB reviewed and approved a number of policy proposals to be submitted to the G20 Summit in November, including on a package of measures to address the "too big to fail" problem.

In respect of key financial regulatory reforms:

- *Addressing systemically important financial institutions (SIFIs)*: The FSB reviewed and approved the package of policy measures to be submitted to the G20 to address SIFIs, which will include:
 - *Key Attributes of Effective Resolution Regimes for Financial Institutions*, which will form a new international standard for the features of all national regimes;
 - a requirement that individual G-SIFIs have recovery and resolution plans, informed by resolvability assessments; and that home and host authorities develop institution-specific cooperation agreements and cross-border crisis management groups;
 - additional loss absorbency requirements for those banks determined to be G-SIFIs, based on the methodology developed by the BCBS;
 - measures to enhance the intensity and effectiveness of supervision, in particular of SIFIs, including improved data systems for risk management at SIFIs; and
 - the enhancement of international standards for the robustness of core financial market infrastructures.
- *Shadow banking*: The FSB reviewed workplans to strengthen the oversight and regulation of shadow banking; and will conduct annual monitoring exercises to assess global trends and risks.
- *OTC derivatives*: Members approved the conclusions of the second progress report on implementation of OTC derivatives reforms, to be published shortly; and, noting delays, urged jurisdictions to achieve the end-2012 deadline for full implementation of the agreed G20 reforms. Members agreed to strengthen their coordination of work to address potential inconsistencies and gaps in the implementation of reforms; and discussed mutual recognition. The progress report clarifies that the G20 reforms to OTC products are to be fully implemented irrespective of whether those products continue to trade OTC or not.
- *Commodities and securities markets*: The FSB reviewed and approved two reports by IOSCO on principles for the regulation and supervision of commodity derivatives markets, and on regulatory issues raised by the impact of technological changes on market integrity and efficiency.

A number of “implementation monitoring” topics, including further reducing reliance on CRA ratings, were discussed; and the FSB gave its further support to global LEIs.

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Capital requirements

As anticipated, on 20 July the European Commission brought forward proposals to change the behaviour of the 8,000+ banks that operate in Europe. The overarching goal of these proposals is to strengthen the resilience of the EU banking sector while ensuring that banks continue to finance economic activity and growth. The Commission’s proposals have three concrete goals.

- The proposal will require banks to hold more and better capital to resist future shocks by themselves. Institutions entered the last crisis with capital that was insufficient both in quantity and in quality, leading to unprecedented support from national authorities. With its proposal, the Commission translates in Europe international standards on bank capital agreed at the G20 level (most commonly known as the Basel III agreement). Europe will be leading on this matter, applying these rules to more than 8,000 banks, amounting for 53% of global assets.
- The Commission also wants to set up a new governance framework giving supervisors new powers to monitor banks more closely and take action through possible sanctions when they spot risks, for example to reduce credit when it looks as though it is growing into a bubble.
- By putting together all legislation applicable on this matter, the Commission proposes to have a Single Rulebook for banking regulation. This will improve both transparency and enforcement.

The proposal comprises two parts: a regulation governing how activities of credit institutions and investment firms are carried out and a directive governing the access to deposit-taking activities.

- The Regulation contains the detailed prudential requirements for credit institutions and investment firms and it covers capital; liquidity; leverage ratio; counterparty credit risk; and Single Rulebook.
- The new Directive covers areas of the current Capital Requirements Directive where EU provisions need to be transposed by Member States in a way suitable to their own environment, such as the requirements for access to the taking up and pursuit of the business of banks, the conditions for their exercise of the freedom of establishment and the freedom to provide services, and the definition of competent authorities and the principles governing prudential supervision. New elements in this directive are enhanced governance; sanctions; capital buffers; and enhanced supervision.

Finally, the proposals will seek to reduce to the extent possible reliance by credit institutions on external credit ratings by:

- requiring that all banks’ investment decisions are based not only on ratings but also on their own internal credit opinion; and
- that banks with a material number of exposures in a given portfolio develop internal ratings for that portfolio instead of relying on external ratings for the calculation of their capital requirements.

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Net Stable Funding Requirement

On 20 July, the European Commission [proposed a revision](#) of the EU Capital Requirements Directives (CRD) coupled with the introduction of a new EU Capital Requirement Regulation, in order to implement the regulatory standards on bank capital and liquidity included in [Basel III](#). The proposals, collectively referred to as CRD IV, will apply to all EU banks (more than 8,300) as well as investment firms; and represent a key contribution towards the aim of establishing a Single Rulebook across all EU Member States.

Aligned with Basel III provisions, the European Commission introduced two new minimum liquidity requirements, and foresees in each case an observation period in order to identify and address possible unintended consequences. To improve short-term resilience for the liquidity risk profile of financial institutions, a Liquidity Coverage Requirement (LCR) will be introduced in 2015. On the other hand, to address funding problems arising from asset-liability maturity mismatch, the Commission also considers introducing a Net Stable Funding Requirement (NSFR).

Complementing the article on LCR included in the [Third Quarter Newsletter](#), the focus of this article is the second of the two liquidity standards, the NSFR. Unlike LCR, the NSFR is still very far from its final version as there are many details that have not been mapped out yet. The European Commission agreed that, before deciding on a final calibration and moving it to a minimum standard in 2018, extensive monitoring of NSFR and its implications will be conducted. Accordingly, CRD IV does not include any provisions on the NSFR, but rather sets out reporting requirements to assess the parameters for and implications of adopting this long-term liquidity ratio. The establishment of the actual regulatory requirements in the EU has been left to another legislative proposal before 2018.

Under the standard, effectively a bank must hold a minimum amount of stable funding, so-called available stable funding (ASF), to support what it is deemed to be the illiquid part of its assets, ie the required stable funding (RSF). As described by the Basel III provisions, the ratio applies over a one year time horizon, to all assets whether on or off

balance sheet, and irrespective of the accounting treatment of the assets involved, ie whether trading, available for sale or held to maturity.

This requires banks to: (i) assess all assets, both on and off balance sheet; (ii) identify the illiquid portion of each asset (RSF), being that proportion which, likely, could not be monetised within a one year stress scenario; (iii) hold equity capital or particular longer term debt (ASF) in an amount greater than the calculated illiquid assets value (ie $ASF > RSF$).

Required and available funding amounts are determined using weighting factors reflecting the stability of the funding available and the duration of the asset. Apart from some very high quality low risk assets (eg cash and money market instruments) which require no stable funding to support them, a proportion of all other assets (ranging from 5% to 100% of their value) must be considered illiquid for these purposes and covered by the ASF in a specified stressed environment. On the other hand, not all the sources of available stable funding have the same weight. Different types of equity and debt financing are expected to be more or less reliable sources of funds over a one year period of stress and thus different weighting factors are applied. Moreover, in order not to create reliance on the central bank as a source of funding, borrowings extended from central bank lending facilities outside regular open market operations are not considered for the purpose of the ASF.

A more detailed analysis of the Basel III and CRD IV provisions for the NSFR, together with some general considerations, has been documented by ICMA in a paper entitled *NSFR: the Net Stable Funding Ratio in Basel III and CRD IV*, which was recently circulated to ICMA ECP and ERC Committee members. Going forward, ICMA will be closely following the implementation of the new liquidity standards in the EU.

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OTC (derivatives) regulatory developments

On 24 August the CPSS and IOSCO [released for comment](#) a report on the OTC derivatives data that should be collected, stored and disseminated by trade repositories (TRs). The proposed requirements and data formats will apply to both market participants reporting to TRs and to TRs reporting to the public and to regulators. The report also finds that certain information currently not supported by TRs would be helpful in assessing systemic risk and financial stability, and discusses options for bridging these gaps. Issues relating to data access for the authorities and reporting entities are discussed, including methods and tools that could provide the authorities with better access to data. The report also covers the mechanisms and tools that the authorities will need to aggregate OTC derivatives data. It advocates a system of standard legal entity identifiers (LEIs) as an essential tool for aggregation of such data. Finally, the report recommends that CPSS-IOSCO or the FSB make a public statement calling for timely industry-led development, in consultation with the authorities, of a standard classification system for OTC derivatives products.

Comments on the report were requested by 23 September. Considering all comments received, a final report will be prepared and published by the end of 2011.

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Regulation of Credit Rating Agencies

On 19 September ESMA [published for consultation](#) its first set of proposed future Regulatory Technical Standards (RTS). The draft RTSs on Credit Rating Agencies (CRAs) detail the information that CRAs would have to disclose and the rules they would have to comply with in order to fulfil the requirements of the CRA Regulation. The draft RTS proposals published by ESMA for consultation cover the following technical areas of conduct for CRAs:

- the information to be provided by a CRA in its application for registration and certification, and for the assessment of the systemic importance to the financial stability or integrity of financial markets;
- the presentation of the information, including structure, format, method and period of reporting that a CRA must disclose;
- the assessment of compliance of CRAs with the requirements set out in Article 8(3) on the credit rating methodologies; and
- the content and format of ratings data to be requested from CRAs as part of their periodic reporting for the purpose of the on-going supervision by ESMA.

In light of the comments received from respondents by the deadline of 21 October, ESMA expects to publish a final report by the end of 2011. In accordance with the ESMA Regulation and the CRA Regulation, those draft RTSs should be endorsed by the Commission to give them binding legal effect.

On 14 September ESMA published [an updated list](#) of list of EU-registered and certified CRAs. This now includes ten registered CRAs and one certified CRA; but as yet the registration process for all of the big three agencies remains to be completed.

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Crisis management

Released on 19 July, the FSB consultative document on *Effective Resolution of Systemically Important Financial Institutions* sets out a comprehensive package of proposed policy measures to improve the capacity of authorities to resolve failing SIFIs without systemic disruption and without exposing the taxpayer to the risk of loss. The proposed measures comprise four key building blocks:

- strengthened national resolution regimes, including statutory bail-in;
- cross-border cooperation arrangements;
- improved resolution planning by firms and authorities; and
- measures to remove obstacles to resolution.

To help inform its final recommendations, the FSB also sought comment on two discussion notes, which reflect the preliminary views of the FSB:

- creditor hierarchy, depositor preference and depositor protection in resolution (Annex 7 of the consultation paper); and
- conditions for imposing temporary stays (Annex 8 of the consultation paper).

Responses to this FSB consultation document were requested by 2 September; and on 9 September the [comments received](#) were published by the FSB. [ICMA submitted a response](#) focused on just one specific aspect – namely bail-in powers, as described on pages 11-13 of the FSB’s public consultation paper and in its Annex 2: *Bail-in Within Resolution: Elements for inclusion in the Key Attributes*. Noting that this topic had been very similarly covered in the European Commission’s [6 January consultation paper](#), *Technical Details of a Possible European Crisis Management Framework*, ICMA drew attention to its response made thereto. ICMA was particularly pleased to note the FSB’s call for bail-in to “be applied in a

manner consistent with the hierarchy of the capital structure of the institution, and respect the rights of secured creditors and the statutory ranking of senior creditors...” (Annex 2, paragraph 5.2); and that the FSB notes that there may be “an appropriate transition period before bail-in powers are exercisable in order to ensure that firms can adequately adjust to the statutory bail-in regime.” (Annex 2, paragraph 12.1).

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Financial transactions tax

In its [press release of 28 September](#), the European Commission announced its proposals for a Financial Transaction Tax (FTT) in the 27 Member States of the EU. The tax would be levied on all transactions on financial instruments between financial institutions when at least one party to the transaction is located in the EU. With effect from 1 January 2014 the exchange of shares and bonds would be taxed at a rate of 0.1%; and derivative contracts, at a rate of 0.01%.

It is estimated that this could raise approximately €57 billion every year. The proposal is that revenues from the tax would be shared between the EU and the Member States. Part of the tax would be used as an EU own resource which would partly reduce national contributions. Member States might decide to increase the part of the revenues by taxing financial transactions at a higher rate.

The proposal will now be discussed by all Member States in the EU’s Council of Ministers and the Commission will present it to the G20 Summit in November.

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Collective action clauses

As reported in the [Third Quarter Newsletter](#), ICMA – supporting the work of the EFC’s [EU Sovereign Debt Markets Group \(SDMG\)](#) – has been actively discussing and considering the best ways in which to formulate collective action clauses (CACs) in euro area sovereign securities, as anticipated by the [European Council conclusions of 25 March](#). Alongside continued discussions on this topic, ICMA was invited to respond formally, by 5 September, to a consultation with interested parties concerning an applicable form of CAC language – launched under cover of a letter dated 23 July from the Chairman of the SDMG.

The views expressed in ICMA’s [duly submitted response](#) reflect the outcome of discussions with members and was prepared with the kind assistance of Clifford Chance LLP. The range of input provided by ICMA’s member firms includes representations made from issuance, intermediary and investor perspectives. As such ICMA’s response presents a synthesised view informed both by firms that act for issuers by arranging issuances of the sovereign debt securities in which the proposed CACs will feature and firms that invest in such securities; thus providing a well informed, broadly based response to the proposals.

ICMA has a particular interest in CACs in view of its publication in October 2004 of standard CACs for the terms and conditions of sovereign notes. This standard form CACs language was developed in response to the 2002 G10 recommendation that CACs be included in sovereign debt contracts; and was cognisant of the April 2003 agreement of EU Member States to include CACs in their international debt issuances. The existing ICMA CACs for sovereign bonds have subsequently been used as a basis for many English law governed debt issues by European and other sovereigns. The clauses form part of the ICMA Primary Market Handbook used by market participants and practitioners, which has for many years served as a pillar of the international debt origination market.

ICMA recognises the underlying objectives and the ambitious goal being pursued by way of the development of standardised euro area sovereign debt CACs and their subsequent mandatory adoption across all new euro area government securities. Whilst being fully supportive of these endeavours, ICMA considers that, as articulated in its response, there are nevertheless some significant considerations which will need to be carefully addressed in the finalisation of this standardised form of CACs language. ICMA believes that the correct approach is to introduce CACs provisions which are as acceptable to – and easily understood by – investors as they can be, whilst still achieving the desired policy objectives underlying their introduction. The market expectation is that the proposed CACs will be based on currently market standard provisions.

In overall terms ICMA thinks that the consultation proposal in respect of standardised euro area CACs unduly favours the sovereign issuer as against investors. This is apparent in, for example, the setting of lower voting thresholds by reference to those attending (or represented at) meetings; the approach to aggregation; the provision for partial cross-series modification; and disenfranchisement more generally. ICMA is concerned that the cumulative effect will be seen in the market as undermining investors’ customary legal protections and as moving away from best market practice. This would ultimately also be contrary to sovereign issuers’ best interests. ICMA believes that it is important that, in introducing CACs provisions, investors do not become concerned about them in a way which would impact negatively on the pricing of new issues or discourage them from investing in euro area sovereign debt.

As a result of recent developments, investors are particularly concerned by the possibility of sovereign debt restructuring in the euro area, and the introduction of the new CACs will be seen as the policy tool chosen by the Eurogroup to facilitate such processes from the sovereign’s perspective. Whilst it is no doubt the case that the introduction of the new CACs will not have any immediate impact on issuance conditions for the strongest core countries with higher credit ratings, the same cannot be assumed to be true across the whole of the euro area.

It is important that any sovereign which suffers a break in market access should not find that the presence of the proposed CACs acts as a further barrier to regaining market access successfully. Investors are also sensitive to the fact that, once introduced, the way in which CACs are utilised, but not their inclusion, could lead to there being a CDS restructuring credit event (under existing ISDA provisions) – albeit this is something which the European authorities have so far been keen to avoid in the context of the private sector involvement relating to Greece.

The proposed CACs will be significantly different from the more traditional form of CACs included in many of the existing foreign law debt instruments issued by European sovereigns, as well as being, for the most part, entirely novel in the context of domestic law governed debt instruments. This is surprising to some market participants, given that the euro area authorities specified that the CACs should be based on those commonly used in the UK and US after the G10 report on CACs of 26 September 2002 (which it is worth noting would not include aggregation).

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A personal view on the euro area crisis by René Karsenti



René Karsenti

The current crisis has to be dealt with urgently and there is a need for an effective crisis management mechanism. We have to be pragmatic. The 21 July policy decisions contained in the statement of Government Ministers of the European Union are not the ideal and complete solutions but they are moving in the right direction. They need to be implemented as quickly as possible. The private sector has also taken up its responsibilities in establishing a Private Sector Involvement (PSI) plan for Greece. There is an urgent

need for a package enhancing the EFSF powers that would enable it to facilitate the intervention in sovereign debt purchases in the secondary market, extend credit lines and create a bank recapitalisation facility. That would represent a step towards the future creation of a European Monetary Fund which over time and with the proper fiscal and economic integration will be able to introduce common eurobonds.

Over the long term, bringing EMU back onto safe ground will of course only succeed if debt and deficits are reduced substantially while proper economic and fiscal governance is put in place. A bold leap is needed. I have confidence that fiscal union will be chosen but I am concerned about the ability of European policy makers to move towards this end swiftly enough while ensuring that their citizens understand the consequences. Debt reduction combined with credible structural reforms takes time, treaties have to be changed. The timetable of democracy is different from that of markets.

In the meantime, as those choices are still in the making, to avoid catastrophic scenarios, the euro area needs a massive infusion of liquidity and a lender of last resort is needed on a more permanent basis to reassure bondholders. The ECB is playing that role. Indeed the ECB is now (rightly) compelled to play a more important role than it would wish. But although very helpful in the short term, this is not a sustainable strategy. Indeed the lack of a lender of last resort, to which problem the timely creation of the EFSF was supposed to be some form of solution has shown its limits. The flaw of the EFSF based on limited size with several but not joint guarantees is exposed.

In my mind, a strategy powerful enough to address this crisis immediately should require governments to:

- provide the EFSF with sufficient firepower to intervene in sovereign secondary debt markets with force probably through the ECB which should get enough financial protection (contingent recapitalisation, guarantees or repurchase agreement). Indeed all euro area members who are judged solvent should be defended with overwhelming financial power. This would provide for the time being the euro area with the lender of last resort it desperately needs;
- allow the debt of countries whose fiscal position is judged unsustainable to be reduced through debt exchanges at a discount; this would help to reduce the debt for fragile countries such as Greece while ring fencing countries judged to have sustainable debt;
- set up a proper pan-European banking resolution mechanism to deal with failing banks across the EU with direct access to resources of a resolution fund;
- over time convert the EFSF into a European Treasury Agency with a new mandate to issue eurobonds for Member States and onlend such funds at cost to Member States subject to their full respect of the conditionalities and budget as approved by the Eurogroup. This right could be waived by simple majority in the Eurogroup in case a country deviates from its fiscal commitments. In such case, the country would then issue new debt with no guarantee.

In conclusion I believe that the gradualism, which has characterised the European response so far, needs to be replaced by a bold leap approach and immediate crisis management along the actions outlined above.

Over time once the threat of cascading defaults and bank runs is eliminated from the fears of the market, I believe a fiscal union is the ultimate destination for the euro area. Of course a fiscal and political union could not be achieved at once but the time has come to accelerate the process of changing the political and institutional structures of the Union with clearly stated roadmap, timetable and milestones in a similar way as during the set up of the Single Market and EMU in the 1990s.

I think all these changes would be very far reaching but they are politically possible. They need to be delivered before year-end and we need European leaders carrying them through within the challenging European democratic process and in particular by making sure that European citizens will be fully informed and understand the consequences of such fiscal and political union.

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Extracted from a speech to the EURO 50 Conference, 25 September 2011, Washington

ECP market

Liquidity regulation: As anticipated, on 20 July the European Commission brought forward its proposals to introduce new capital and liquidity requirements, broadly aligned to the agreed Basel Committee on Banking Supervision (BCBS) “Basel III” texts that were published in December 2010. In the context of the ECP Committee the particular aspects of the proposals which are of greatest interest are those concerning new requirements for liquidity. The European Commission is firmly committed to reaching a harmonised Liquidity Coverage Requirement (LCR) by 2015. This is to be preceded by a general requirement, to apply from 2013, for banks to keep appropriate liquidity coverage; along with a detailed reporting regime to facilitate observation and review. This is much like the regime described in Basel III, although a number of details are left to be filled in following reports to be prepared by the EBA. Complementing LCR, the BCBS has also agreed a Net Stable Funding Ratio (NSFR) whose implementation is scheduled for January 2018, with final revisions to be made by 2016. In relation to NSFR, the European Commission’s text does not contain any explicit provisions, but rather sets out preliminary reporting requirements to assess the parameters for and implications of adopting an NSFR.

Money market funds: At the Institutional Money Market Funds Association (IMMFA) Annual General Meeting in June, amendments were approved to the IMMFA Code of Practice. These amendments included new risk management requirements, designed to limit credit and liquidity risks. The risk mitigation mechanisms are supported by additional disclosure requirements in order to allow investors to better compare, contrast and assess risk. IMMFA members have until December 2011 to achieve compliance with the new obligations contained in the Code.

On 26 August ESMA published a document entitled *Questions and Answers – A Common Definition of European Money Market Funds*. The purpose of this document is to promote common supervisory approaches and practices in the application of the *Guidelines on a Common Definition of European Money Market Funds* (MMFs) developed by CESR, by providing responses to questions posed by the general public and competent authorities. This document is intended to be continually edited and updated as and when new questions are received. The date on which each question was last amended is included after each question for ease of reference. Separately, dated 3 September, there is a new ECB Regulation which gives a detailed specification of MMFs for the purposes of statistical reporting.

As reported in its 1 September press release the FSB is progressing its work on shadow banking. Its task force has conducted a further data and information sharing exercise during the summer; has developed general principles for designing and implementing regulatory measures; and has conducted a regulatory mapping exercise to take stock of existing national and international initiatives on the four broad categories of possible regulatory measures set out in the FSB’s April background note. As a result of this, the task force has identified five areas where more detailed work is warranted to help gauge the case for further regulatory action, one of which is stated to be “the regulatory reform of money market funds”. In order to make progress, the FSB has decided to set up dedicated workstreams to focus on each of these areas. The workstreams will report their progress as well as the proposed policy recommendations to the FSB by July 2012; following which the FSB will elaborate on the recommendations for strengthening the oversight and regulation of shadow banking in a report for the G20 in October.

ECB collateral requirements: On 21 September the ECB published an updated consolidated version of *The Implementation of Monetary Policy in the Euro Area: General Documentation on Eurosystem Monetary Policy Instruments and Procedures*. Amongst the changes included in this version, the Eurosystem has abolished the eligibility requirement (Sections 6.2.1.5 and 6.2.1.6) that debt instruments issued by credit institutions, other than covered bank bonds, are only eligible if they are admitted to trading on a regulated market. The effect of this is that from 1 January 2012, securities issued by credit institutions trading on certain other markets accepted by the ECB will be eligible as well. The Short Term European Paper (STEP) market is such an ECB accepted market as are certain other national markets, including, among others, Luxembourg’s Euro MTF, the OTC market for Belgian commercial paper and the French commercial paper market. *ABCP collateral requirements:* On 29 September the EBA published a question and answer report on the Guidelines on Article 122a of the CRD. Within this new publication, Section II.A: *ABCP Conduits* is of specific interest. This provides clarification by addressing the following three questions:

- Q6: Retention by sponsors via “second loss” programme wide credit enhancement (Ref: Guidelines § 57 and footnote 13);
- Q7: Due diligence and disclosure requirements in ABCP transactions; and
- Q8: Exemption from the need to disclose loan-by-loan level data for highly granular portfolios (Ref: Guidelines § 128).

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Repo market

ERC report on the interconnectivity of central and commercial bank money: In its [14 September press release](#) ICMA announced the publication of a [new report](#), prepared for the ERC by Richard Comotto of the ICMA Centre, *The Interconnectivity of Central and Commercial Bank Money in the Clearing and Settlement of the European Repo Market*. This report has been produced in the context of regulatory efforts to reduce systemic risk by better underpinning the smooth functioning of clearing and settlement in Europe. It compares central and commercial bank money, noting that, while central bank money is an inherently risk-free asset and its use gives confidence in times of crisis that payments will continue to be made, commercial bank money is nevertheless widely used, because the risks can be managed down to minimal levels and because central bank money is not always available. The report calls for balance in re-engineering the payment architecture. It highlights the critical role of commercial bank money in making multi-currency, cross-border payments and cautions that this role is becoming ever more important. As the demand for high quality collateral increases, partly at the insistence of regulators, and the supply diminishes, there is a growing need among banks to be able to mobilise collateral between currencies and across borders.

In his foreword to the report the ERC Chairman states that: "The publication of this new paper will facilitate future developments, amongst which high on the list of priorities of the ERC are:

- development of interoperability for triparty between both ICSDs – Euroclear and Clearstream;
- unfettered access by all types of trading venues, be it electronic or voice, to all CCPs irrespective of the location of the collateral; and
- improved European-wide access to liquidity, fully respecting the level playing field for all users.

Follow-up work is under way to ensure that these priorities are effectively progressed.

ERC recommendation on repo matching as a driver for risk reduction: Following from work conducted by the ERC Operations Group, under the oversight of the ERC Committee, the ERC has published a statement entitled *ERC Recommendation on Repo Matching as a Driver for Risk Reduction*. This statement, which in summary calls for improvements in trade date matching procedures for repos, is available on the ICMA's website, on the page which provides access for [Repo Trading Practice Guidelines & Documentation](#). ERC Committee members are henceforth recommended to take this best practice statement into account when determining their internal working practices.

Calculation of the reinvestment period regarding a buy/sell-back transaction

Earlier this year, the ERC Committee received a query from a member seeking guidance about the calculation of the number of days for which a coupon on a bond being used as collateral in a buy/sell-back transaction could be reinvested, if it was paid over a weekend. The specific example was a buy/sell-back with a repurchase date of 18 August 2011. The next coupon date on the bond was Saturday, 30 July 2011. In a buy/sell-back, the manufactured payment triggered by a coupon payment is not paid on the coupon date but is deferred to the repurchase date and accordingly the repurchase price is net of the manufactured payment plus the reinvestment income on the payment over the period between the coupon date and repurchase date. The trading venue and an information vendor had calculated the reinvestment period to be 17 days, but the CCP had calculated 19 days.

The problem had been rapidly resolved (the CCP has amended its algorithm) but the ERC felt it was important to set out the correct practice. The reinvestment period should start on the Monday when the coupon was actually paid. One of the principles underlying repo is that, other than a borrowing fee, collateral repoed out should not yield more or less to the seller than if that collateral had not been repoed out. As an investor holding the collateral in question, and not repoing it out, would only have been able to reinvest the coupon from the Monday, when it was paid, this was the appropriate treatment under repo.

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Capital and liquidity: As anticipated, on 20 July the European Commission [brought forward its proposals](#) to introduce new capital and liquidity requirements, broadly aligned to the agreed BCBS “Basel III” texts that were [published in December 2010](#). There are three particular aspects of the proposals which the ERC has taken specific note of:

- *Liquidity:* The European Commission is firmly committed to reaching a harmonised Liquidity Coverage Requirement (LCR) by 2015. This is to be preceded by a general requirement, to apply from 2013, for banks to keep appropriate liquidity coverage; along with a detailed reporting regime to facilitate observation and review. This is much like the regime described in Basel III, although a number of details are left to be filled in following reports to be prepared by the EBA. The main details of the new liquidity rules are to be found in part six (articles 400-415) of the proposed Regulation (which can be found in the third pdf part of the consultation paper); although articles 444, 480 and 481 are also relevant, along with Annex III.
- *Leverage:* In line with Basel III, the European Commission does not propose a Leverage Ratio as a binding instrument at this stage but first as an additional feature that can be applied on individual banks at the discretion of supervisory authorities with a view to migrating to a binding (“pillar one”) measure in 2018, based on appropriate review and calibration. It is proposed that institutions publish their Leverage Ratios from 2015. The main details of the new leverage rules are to be found in part seven (articles 416-417) of the proposed Regulation (which can be found in the 3rd pdf part of the consultation paper); although articles 436, 475 and 482 are also relevant and so, in the context of netting, is article 201 (found in the second pdf part of the consultation paper). Repo netting (except contractual cross-product netting) is expressly provided for in accordance with article 416.7.
- *Exposures to CCPs:* Within the section on “Capital requirements for credit risk” the rules concerning “Credit risk mitigation” are to be found in chapter 4. Section 9 of this chapter relates specifically to the topic of “Own funds requirements for exposures to a central counterparty” (articles 294-300: found in the second pdf part of the consultation paper). Article 297.1 provides for the anticipated special 2% risk weight for trade exposures with CCPs.

Crisis resolution: On 19 July the FSB issued a consultative document entitled [Effective Resolution of Systemically Important Financial Institutions](#), which includes proposals concerning a temporary stay on early termination rights. These proposals are broadly similar to those made in the European Commission’s [January consultation](#) on technical details underpinning its proposed crisis resolution framework. The ERC [submitted a response](#) concerning repo-oriented aspects, reiterating the messages delivered in its 3 March response to the European Commission.

Shadow banking: As reported in its [1 September press release](#) the FSB is progressing its work on shadow banking. Its task force has conducted a further data and information sharing exercise during the summer as a step toward evaluating and adjusting the proposed framework. This could lay the basis for data collection and assessment by the FSB of global trends and risks in shadow banking from 2012 onwards.

The task force has also developed general principles for designing and implementing regulatory measures; and has conducted a regulatory mapping exercise to take stock of existing national and international initiatives on the four broad categories of possible regulatory measures set out in the [FSB’s April background note](#). As a result of this, the task force has identified five areas where more detailed work is warranted to help gauge the case for further regulatory action, one of which is stated to be “the regulation of activities related to securities lending/repos, including possible measures on margins and haircuts.”

In order to make progress, the FSB has decided to set up dedicated workstreams to focus on each of these areas. The workstreams will develop preliminary work plans shortly, and report their progress as well as the proposed policy recommendations to the FSB by July 2012 (or end-2012 for securities lending/repos). The FSB will elaborate on the recommendations for strengthening the oversight and regulation of shadow banking in a report for the G20 in October.

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21st semi-annual repo survey

The ICMA ERC released the [results of its 21st semi-annual survey](#) of the European repo market, undertaken in June, on 14 September. The survey sets the baseline figure for market size at €6.2 trillion. Using a constant sample of banks that have consistently appeared in all recent surveys, the size of the market showed modest growth of 3.6% since the December 2010 survey and year-on-year growth of 10.2%. These figures indicate a pronounced upward trend since 2008, although the survey was carried out before the market turbulence of the summer.

Analysis of returns from 59 institutions, including most of the major repo market participants in Europe, shows that the structure of the market has adapted well to various challenges that are the legacy of events since 2007. The volume of electronic trading and clearing across CCPs that was already taking place in the European repo market prior to 2007 (and prior to regulatory pressure on OTC markets to adopt such trading methods) has grown and the role of CCP-cleared electronic trading has been consolidated.

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Prospectus Directive review

As contemplated on page 20 of the [Third Quarter edition](#) of this Newsletter, on 15 July ICMA submitted its [response](#) to the 15 June [consultation](#) of ESMA on the Level 2 measures of the review of the EU's Prospectus Directive Regime. In the response, and given the short timeline for the consultation, ICMA focused on concerns relating to the general approach taken by the consultation.

In particular, the response highlighted the apparent inconsistency – with the Prospectus Directive, with various EU Member State approaches to consumer protection and also potentially with any local rules applicable to prospectuses also being used in non-EEA jurisdictions – of ESMA's proposed restrictive and mechanical approach to final terms. It also noted the likely significant increase in review burden for Member State competent authorities. ICMA's suggested approach to resolve the question of what can, and what cannot, be included in final terms is set out at item C in the annex to ICMA's [25 February response](#) to ESMA's [January call for evidence](#).

In relation to ESMA's proposal concerning the prospectus summary (and particularly the new drawdown summary concept), the ICMA response highlighted the proposal's duplication of requirements with the ongoing PRIPs initiative and its conflicting approach to disclosure (namely that the same information needs to be stated in a different way – the summary must be consistent with the body of the prospectus and it is extremely difficult to say the same thing using different words and a different tone). ICMA also expressed concern that the summary's proposed purpose, format and content appear to contradict that set out in the Prospectus Directive. Finally ICMA was puzzled at the ban on cross-references, given their utility.

Following the responses received, ESMA published its [final report](#) to the Commission on 4 October. This will now be reviewed by ICMA and its members with great interest.

In the meantime, several EU Member States have begun transposing (entirely or just partially), ahead of the final deadline of 1 July 2012, the Level 1 amendments to the Prospectus Directive itself. Market participants may need to be vigilant in ensuring that transactions follow the amended regime where applicable – particular consideration may need to be given to whether “amended” host Member States have expressed any reservations at receiving passported transactions from “un-amended” home Member States during this transitional period.

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New issue processes

In the years following the onset of the financial crisis, markets have faced new and continuing levels of volatility as well as increasing regulation across all financial centres. Market participants have been focused on ensuring that market practice in this changing environment continues to be fully compliant with law and regulation and one recent area of focus has been the treatment of potentially material non-public information in the primary debt markets' bookbuilding and allocation processes. With this in mind, ICMA has facilitated roundtable discussions between issuers, lead managers and investors (see most recently the report at page 22 of the [Third Quarter edition](#) of this Newsletter).

In this context, ICMA published in March 2009 [ICMA Recommendation 1.30](#) (R-1.30) on coordinating the pre-sounding of transactions (see relevant article at page 14 of the [April 2009 edition](#) of this Newsletter, including links to interesting FSA guidance) and in October 2010 [ICMA Explanatory Note XIII](#) (EN-XIII) on pre-sounding, bookbuilding and allocations. This article elaborates further on some of the aspects relating to announcements, investor meetings, pre-sounding in the context of price discovery and orderbook disclosure, and emphasises the importance of lead managers agreeing a joint approach to such matters in the context of an individual transaction.

Under the EU's Market Abuse Directive (MAD), information ceases to be unpublished price-sensitive information once it has been made public in any way. Issuers are sometimes required to publish information using designated information services, and publishing information via those services constitutes a “safe harbour” from allegations of market abuse in relation to that information. Such safe harbour channels tend to be both national- and equity market-focused in scope and so might not be the most efficient or practical means to disseminate transaction-related information for the international bond markets. In the context of new bond issuance, lead managers generally seek, where they can, to use alternative channels that participants in the relevant market segment are reasonably expected to have access to (even if not free of charge).

Many issuers, particularly in volatile times, focus on ensuring investor familiarity with their businesses in order to maximise their ability to take advantage of short and unpredictable issuance windows. This may include holding a series of meetings with investors that, unlike transaction-specific or “deal” roadshows, are not intended to result in a specific

immediate transaction (though one might follow if feedback indicates an unexpected issuance window appearing to open). Whilst issuers do not communicate material non-public or inside information concerning their businesses in such meetings (focusing rather on outlining published financials, issuance programme prospectus, etc), notice of such meetings is often publicly disseminated at the time participants are invited – particularly in the case of infrequent issuers without publicly announced borrowing programmes. This helps address any participant concerns that knowledge of the timing of such meetings might be subsequently characterised as constituting material non-public or inside information of forthcoming issuance.

EN-XIII and R-1.30 already contain a certain amount of information concerning the pre-sounding, on behalf of issuers, of investors on possible transactions. Additionally, where material non-public or inside information is concerned, the prior consent of the persons to be pre-sounded is required to be obtained, records are required to be kept (eg of the persons who have been pre-sounded, of the time of the pre-sounding and of the information disclosed), and insider lists are to be updated. Such requirements are generally also incorporated into applicable compliance policies.

Even following public announcements of transactions, issuers and lead managers may at times have insufficient certainty as to likely pricing to be able formally to issue price guidance and open orderbooks (bearing in mind that investors expect price guidance, in very limited number of iterations, to be only tightened towards final pricing). This may be so particularly in volatile markets if there has been insufficient investor willingness to participate and provide meaningful feedback in any pre-sounding (see further explanation of pre-sounding in EN-XIII) ahead of a public transaction announcement. In such circumstances, lead managers may implement an intermediate price discovery step following public transaction announcement. This involves public dissemination of more tentative price indications, on which lead managers then actively seek feedback. Such indications are clearly designated as such in order to distinguish them from formal price guidance – this is because, unlike formal price guidance, they may involve several successive iterations that may widen as well as tighten. Designations used have included “price discovery”, “price thoughts”, “price level under discussion”, etc. The term “price whisper” was also used, but is felt by many to imply some form of nonexistent confidentiality. Non-EU markets (notably in the US) may take a different approach to that outlined here.

Investors should, and generally do, make their investment decisions on the basis of transaction “fundamentals” (ie the issuer’s business and the proposed terms of the issue) rather than “technicals” (eg demand from other investors). Some investors may have understandable reasons for wanting to know levels of demand, and so seek disclosure of orderbook status. However, some investors also seek such information in order to magnify their orders where there is substantial oversubscription and so to improve the likelihood of securing individual allocations that, albeit reduced because of the oversubscription, match their true underlying demand (see EN-XIII for further information concerning inflation of orders and principles of allocation). Ultimately, lead managers agree, in the circumstances of individual transactions, what degree of disclosure is appropriate to be made before publicly disseminating it. Any such disclosure is required by law to be clear, fair and not misleading and so issuers and lead managers have to be wary of orders that might not represent true demand. This may result in a conclusion in individual cases that no information relating to the orderbook should be disclosed. Incidentally, in relation to post-transaction disclosure of distribution, ICMA has previously published [ICMA Press Statement 1](#).

ICMA is aware that many practitioners would favour less complexity in the new issue process, particularly in relation to the treatment of potentially material non-public information. However, the issues involved are complex, notably because the underlying law is complex. Development of further guidance might be possible in due course, but only after detailed review by legal and compliance functions as to the practicability of any proposal and congruence with any views expressed by regulators. In this last respect, ICMA understands that some regulators have been focusing for some time on issues in this area and hopes any future regulatory developments (including as part of the reviews of MAD and MiFID) will result in a practical and uniform pan-EU approach.

The above has no bearing on issuers’ obligations to publish material non-public information as soon as possible where required to do so by law, which exist in parallel to, and are unaffected by, the issues described above.

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UK Listing Authority

On 12 September, ICMA submitted a [response](#) to the latest [consultation](#) (The Blueprint for Reform) by HM Treasury on the UK Government's *New Approach to Financial Regulation*.

The response focused on concerns to an extent previously raised in ICMA's [October 2010](#), [December 2010](#) and [April 2011](#) responses to HM Treasury's prior consultations in this area (and covered in [the then subsequent editions](#) of this Newsletter). In this respect, the response picks up on risks arising from confusing, in a regulator's guiding mandate, retail markets with institutional markets and disclosure regulation with product regulation.

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Bank issuers of unsecured debt

The long-awaited UK Independent Commission on Banking's (ICB) [Final Report](#) was released on 12 September.

In its Interim Report, the ICB suggested that banks should have greater loss absorbing capacity, as well as simpler and safer infrastructures. The Final Report fleshed this out with the recommendation that the retail and other activities of large UK banking groups should have adequate loss-absorbing debt, including primary loss-absorbing capacity, of at least 17%-20%, comprising equity and other capital. Fundamentally, it also recommended that regulators should have the power to impose losses on other creditors in resolution if primary loss-absorbing capacity is wiped out.

The ICB believes that, while equity is the simplest and surest form of loss-absorbing capacity, other types of loss-absorbing capacity such as long-term unsecured debt have an important role to play alongside equity – not least because debt holders have a particular interest, in a way that equity holders do not, in guarding against downside risk.

The ICB also recommends depositor preference for deposits insured by the Financial Services Compensation Scheme, which would then rank higher than other unsecured debt in the event of insolvency.

On the one hand, this basic premise that banks need to hold more equity relative to their assets effectively increases the chance that investors in the debt of troubled banks will take a loss-bearing hit, in stark contrast to the 2008 bail-out by the taxpayer. However, on the other hand, fears arise for the marketability and credit ratings of unsecured bank debt, which may be perceived as much riskier, with the result that investors may be likely to demand a premium to buy it, or even that UK banks may be shunned by credit investors in favour of overseas competitors where the proposals on capital may be perceived as more favourable to debt holders.

The Final Report will clearly be of great significance to the ICMA Financial Institutions [Issuer Forum](#), which gathers the major financial institution group issuers from amongst ICMA's members to discuss issues of common interest to them. Please contact Katie Kelly to register your interest in joining the Financial Institutions Issuer Forum.

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Swiss selling restrictions

In June, a group of eleven Swiss firms published a [position paper](#) on cross-border debt offerings by foreign issuers into Switzerland. It is hoped that the alignment of interpretations in the paper will help simplify market understanding of selling restrictions applicable to offers into Switzerland and so facilitate market processes.

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MiFID review

In the previous Newsletter, we wrote that the European Commission's proposals were expected before the summer break. At the time of writing, observers expect the official proposals to appear in mid-October. It seems likely that the proposals will be brought forward in two packages, a Directive containing the proposals which need careful integration into the national law of Member States and a Regulation covering areas where a single, directly applicable law is technically preferable. Advanced draft texts are circulating unofficially, from which certain salient features of the Commission's approach can be discerned. This article highlights the policy approach in selected areas and outlines the future timetable.

By way of background, readers will recall that one of the principal areas to be tackled in the MiFID review process was the lessons to be learned for other markets of the reforms to the pre- and post-trade transparency of the equity market implemented in consequence of MiFID I.

On the linked topics of market structure and price transparency for non-equity products, the policy objective of reducing over-the-counter trading and channelling trading to transparent, centrally cleared, regulated markets is maintained. The existing categories of trading venue, Regulated Markets (RMs), Multilateral Trading Facilities (MTFs) and Systematic Internalisers (SIs) continue, but with some changes. In the case of SIs, the category is extended to fixed income markets. A new class of venue, the "Organised Trading Facility" (OTF) is proposed. The draft envisages that pre- and post-trade transparency would apply to all bonds admitted to trading on a RM, or subject to a prospectus. Waivers from pre-trade transparency (for RMs, MTFs, and OTFs, but not SIs) would be subject to close regulatory control, coordinated at EU level by ESMA according to standards specified in legislation. Thresholds for delayed reporting of large trades would be determined in later Level 2 legislation. The draft does not follow ICMA's recommendation to limit transparency to more liquid bonds in order to protect investors and maintain liquidity.

Operators of OTFs will be able to restrict participation (unlike RMs or MTFs, which are in principle open to all investment firms) and will be allowed to use an element of discretion in matching clients' orders. However, as proposed, an OTF operator will not be able to transact business by committing its own capital. This would be problematic for a number of existing facilities, currently operated in the EU with investment firm or credit institution licences. The new concept of an OTF has been introduced without consultation on its detailed implications for bond markets. We believe that single dealer platforms (where clients deal with a particular dealer) should be allowed to be OTFs and not forced to be SIs.

A particular difficulty with the changes to the SI regime is that, when an SI responds to a client's request for quote (RFQ), the SI will be obliged to offer that quote to its other clients. While the quote to other clients would be subject to a size limit (to be specified in later Level 2 legislation), and limits could be placed on the number of trades accepted against the quote from other clients, the potential to disrupt liquidity provision, impede response to client needs, and destabilise markets, seems very great. Though minor adaptation of the equity-based SI requirements (which, for example, require a public quote) may be an attempt to adapt to the specific characteristics of bond and derivative markets, the draft does not seem well adapted to meet user needs in diverse non-equity markets at this stage.

Another important concern is that, as drafted, transparency obligations would apply to all "financial instruments", which would include money market instruments. We will continue to seek a restriction of the scope to transferable securities and derivatives, to avoid harming the money markets. Proposed extensions to the scope and content of transaction reporting to regulators will also need careful scrutiny.

The Commission's approach to price transparency recognises that primary legislation is not the place to prescribe requirements in detail. The approach is therefore to empower the Commission, advised by ESMA, to make the necessary detailed rules. It seems likely that this will take the form of a Regulation, directly applicable in all Member States. Two potential difficulties with this approach have been identified, which will require careful handling if the proposals enacted are to bring benefits to European markets at reasonable cost, avoiding rigidity and potential inefficiency.

- The first is that price transparency rules set by the official sector may not be sufficiently flexible when market conditions change; this has already adversely affected equity markets. In that case, the thresholds for delayed reporting of large trades were too high as turnover reduced through the crisis. It will be important to build flexible requirements that can be adapted when market conditions change.
- The second potential difficulty is political rather than technical. The European Parliament will be asked to delegate significant lawmaking ability to the new regulatory arrangements. It is important to recall that ESMA only began operations in January 2011. The Parliament has been given an expanded role by the EU (Lisbon) Treaty, and has shown itself willing to exercise this role. In these circumstances, it cannot safely be assumed that the delegation of powers to the Commission advised by ESMA will be wholly uncontroversial.

Another potential difficulty identified by observers relates to the purchase, by or on behalf of clients based in the EU, of investment services from a provider outside the EU. An example might be the use of a local broker in Asia to obtain access to an Asian trading venue. As currently drafted, it seems the proposals could require the Asian broker to be authorised and – potentially – to comply with EU conflict of interest, conduct of business, market transparency, and transaction reporting rules.

In addition, we shall need to keep a close eye on the proposals in relation to the classification of products into complex and non-complex and the proposed changes to the client classification regime. Both these policy areas have implications for the manufacture and distribution of structured products, particularly but not only to retail clients.

Another aspect of the proposals likely to require careful handling is the relationship between the MiFID proposals and the US Dodd-Frank Act, passed in July 2010 and now being implemented. Policy makers on both sides of the Atlantic are aware of this and there is increasingly close contact, at senior political level, between MEPs, US Congressmen and US Senators and between officials at the European Commission and ESMA on the one hand and the US Treasury and the US regulatory agencies on the other.

Turning to the timetable following formal publication of the proposals, the steps in the process are as follows. The Member States form a Council Working Group comprising financial *attachés* and national experts. The Council Working Group considers the text and Member States propose amendments. In parallel, the European Parliament appoints a *rapporteur* and shadow *rapporteurs* to co-ordinate the parliamentary scrutiny process. The *rapporteur* produces a report to Parliament, proposing amendments to the Commission's original proposal, which is voted on by the relevant parliamentary committee and then by the whole Parliament in plenary session. If the text agreed by the Council and the text voted on by the Parliament are materially different, a three-way negotiation takes place, referred to as a "trilogue" to resolve the differences.

At the time of writing, it seems likely that little progress will be made on the MiFID texts by the Council during the remainder of 2011, given the Presidency's other priorities; but it is expected that the pace of work on the dossier will pick up substantially in 2012. On the most optimistic assumptions, the earliest the text is likely to be ready for political agreement is mid-2012. Since significant areas remain to be filled in by secondary legislation, this work is likely to take a further year; and given the breadth of the impact on the industry's systems, a further significant period will be needed for technical adaptations before full implementation.

While not an exact parallel, it is worth recalling that the MiFID text was proposed in November 2002 and passed into law in April 2004. Secondary legislative texts in the form of a Commission Directive and Commission Regulation were officially published on 2 September 2006. The deadline for incorporation of the provisions into national law was 31 January 2007 and nine months was allowed for firms' technical adaptation; MiFID therefore came into force in November 2007, five years after it was formally proposed. In current circumstances, it is unlikely that such a long timetable will be permitted, since many parts of the proposals are related to the regulatory repair programme initiated after the onset of the financial crisis and other aspects relate closely to the G20 commitments, particularly in relation to the trading and clearing of over-the-counter derivatives.

As usual, we will seek to co-ordinate with other trade associations where we can.

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Post-trade operational issues

ICMA has been working on a range of post-trade operational issues. In the current low interest rate environment, the incentives for prompt settlement of trades are weakened and we are therefore discussing a range of options with members to consider ways in which operational performance can be improved and “problem trades” can be pro-actively managed.

The first step is prompt confirmation of trades. Since the implementation of our General Recommendation in January 2011, we have been discussing obstacles to the more widespread take-up of electronic trade confirmation services. The principal obstacles appear to be a lack of common messaging formats and, consequently, a lack of interoperability between the various services.

Turning now to the consequences of a trade which fails to settle on the due date, we have become aware of areas in which the present rules for cash market trading do not integrate well with the arrangements for settling repo trades, particularly but not only in the area of fails management. Members have also reported practical difficulties in operating the buy-in rules. While the general view is that the rules themselves are adequate, work is in hand to explore ways in which processes such as identifying the holders of a particular bond and informing them that a “buy-in” situation exists can be carried out by the firm or entity best placed to do so. If implemented, this should mitigate some of the issues.

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Covered bond transparency consultation

The ICMA Covered Bond Investor Council (CBIC) has promoted the high quality, simplicity and transparency of the covered bond product since the CBIC's creation two years ago. In this context the CBIC set up a Transparency Working Group which tried to identify key information which covered bond investors required to make well informed investment decisions. The consultation considered a mix of quantitative and qualitative information, as regards general issuer data and cover pool data. The consultation period was over in June. However, the CBIC is still receiving feedback from major market players, and will need to consider these comments.

The CBIC has received feedback from different actors in the covered bond market: investors, issuers and also national and European regulatory bodies. Half a dozen investors responded to the consultation paper in addition to the investors involved in the drafting of the template. Overall the feedback has been positive, and the project has been perceived as a major step towards a better functioning covered bond market. Of course, other transparency projects such as the ECBC labelling project, which includes a transparency pillar as well as the national regulators transparency requirements, have also been mentioned by several respondents. It is clear that a balance needs to be struck between providing comparable, timely, frequent and easy to access data, limiting the administrative burden that will fall upon the issuers, and alignment with the other transparency projects.

The CBIC will be convening a number of Working Group conference calls with its members and the respondents to the consultation in the coming month. The major themes that will be discussed are:

- Investors' needs and additional fields:* Investors as a whole consider that the template is comprehensive. However, some investors mentioned some detailed fields they would like to add to better assess credit risk and at the same time are mindful that it is also better to ask for information that all issuers can actually provide in order to compare programmes. Investors do not have the same need in terms of data and also differ in what they consider to be important, and this is why the template is comprehensive. It reflects a consensus of investors' approach to the analysis of covered bond programmes today, but also the likely additional information that will be needed in the near future. Some issuers also mentioned the issue of audited and unaudited information, which will be discussed among investors.
- Clarification of definitions and concepts:* The consultation paper and template did not on purpose provide definitions of concepts which usually differ at national level, but requested issuers to explain the definitions in the qualitative section, to ensure comparability. However, the CBIC did urge some consistency in the definition of concepts at national level. Some national issuer associations took the point on board and mentioned they would work on this, a step welcomed by the CBIC. However, the CBIC is conscious that some concepts or quantitative data requests may not have been as clear as they should have been and will work with issuers to clarify their requests. In addition, because of national traditions, some concepts may be more relevant in one jurisdiction than another and this will also be considered carefully.
- Format, frequency and access:* In addition to the content side of the consultation, the CBIC asked for feedback on the electronic platform it proposed to put in place to ensure easy access for all investors to the information. This is a key element to the project, and the CBIC will need to work further on this with investors, issuers and the CBIC Secretariat. The format of the template as well as the frequency of information sharing is key for all market participants, as it has a direct impact on the future administrative burden on issuers, but also on the degree of comparability of the information by investors. Investors will be discussing this topic at their first meeting.

The work programme will start in the second half of October, and the CBIC is keen to engage with the widest possible audience. CBIC members have been talking at different events on its transparency work, most notably in at the ECBC Plenary in Barcelona. The final template, the result of this next consultation phase, will be available by the end of the year.

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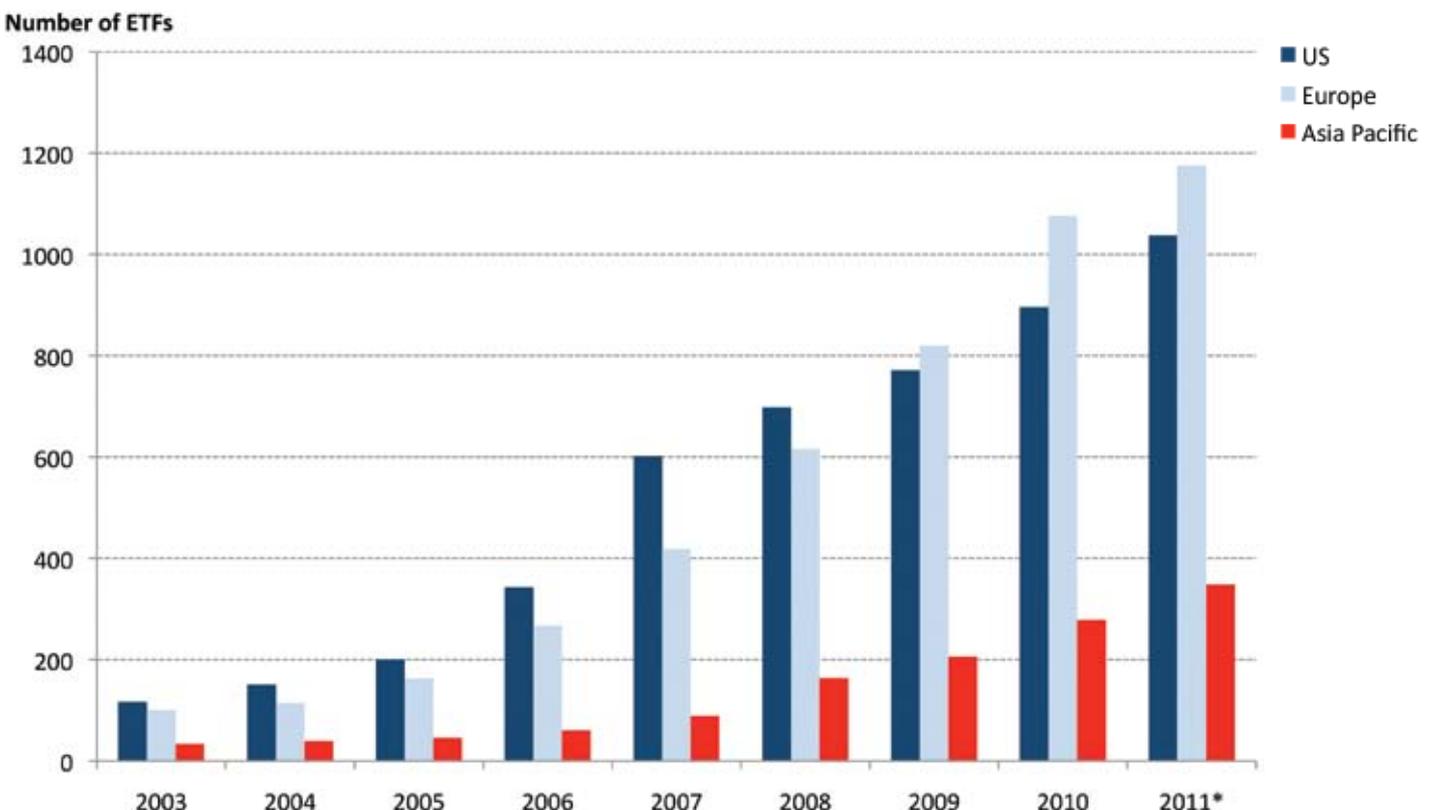
Exchange-traded funds

The AMIC set up, following its December quarterly meeting, an ETF Working Group to highlight issues related to the evolution of the product under the leadership of John Nugée of State Street Global Advisers. The Working Group was composed of providers as well as investors. The Working Group noted the increased interest from the official sector and regulatory authorities in the ETF space.

The report of the Working Group, which was presented at the ICMA ETF Roundtable held in London on 26 September, has three main parts. Part 1 is a descriptive section, with 4 sub-sections A-D which set out the current state of the ETF market; Part 2 is an assessment section, with 3 sub-sections

E-G which look at the trends and assess how the ETF market is likely to continue to develop, and considers the consequences for markets, investors and regulators alike; and Part 3 is a concluding section with conclusions and recommendations.

The report notes that the growth of the ETF market is linked to genuine end-investor demand. The product is understood by investors and to a very great extent retains their confidence and trust. The Working Group expects the recent growth in the number of ETFs to continue and the assets under management in ETFs to continue to rise. Indeed it is very possible that the growth of the market will encourage even more providers to enter the market, so that the outlook could be for the ETF sector to play an increasingly important part in both retail and institutional investment.



Historical global ETF industry evolution: number of ETFs by region

Source: Deutsche Bank: July 2011 report

*As of 24/06/2011

The Working Group considers that it is important that ETFs are seen as part of the general investment landscape rather than unique and distinct from other forms of investment. Rules and regulations applied to ETFs should therefore not be out of line with those applied to other investment vehicles, as was mentioned in the [AMIC response to the ESMA discussion paper](#). On a practical note, the definition of what is and is not an ETF is not precise: the lack of ownership of the ETF “brand” means that no single body – official or industry association – “owns” the ETF name and can therefore grant or withhold it (unlike, for example, the UCITS appellation, which is owned by the European Union and entirely within its control). It follows that any legislation aimed at ETFs per se risks being based on a weak and informal appellation: if the regulatory environment for ETFs becomes too onerous, providers will simply call their products something else.

The report urges regulators to consider commensurate and proportionate measures in line with the risks posed by the ETF product. The emphasis should be on more transparency rather than the implementation of restrictive practices affecting ETF products. Members of the Working Group feel strongly that the risks inherent in an ETF structure should be clearly explained; but this call for increased and understandable transparency is in fact a general principle which should apply to all investments, not specifically or uniquely to ETFs.

The report will be the basis of further discussion on this topic with regulators at national and European levels.

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AIFMD implementing measures

At a general level, the AMIC considered that ESMA’s draft advice on AIFMD implementing measures added useful clarification and detail to the Level 1 text. Some points made in the AMIC January submission had been taken into account. Importantly, ESMA had recognised that proportionality and flexibility were required on the basis of the diversity of entities likely to fall within the scope of the AIFMD. Moreover, efforts for consistency with other regulatory measures, such as UCITS and MiFID, had been made, where appropriate. Additionally, ESMA has taken account of current market practices and the costs and other impacts associated with significant changes, which is of course key for a competitive European asset management industry going forward and for the investors who rely on access to specialist investment management techniques.

In its response, the AMIC took the opportunity to highlight that AIFs are mainly designed for professional investors and that professional investors are more aware of the risks inherent in this kind of investment. Therefore, the measures applying to AIFs should not be more restrictive than those of the UCITS Directive or the protections which are cited in MiFID.

The AMIC noted, together with other trade associations, that it would welcome further clarification as regards the depositories provisions and ensuring consistency with the AIFMD Level 1 – provisions that are key to the operational aspects of the asset management industry work.

AMIC members believed and recalled that, as mentioned in point 1 of their response to ESMA dated 17 January: “the value of the industry rests upon its diversity of legal structures and strategies. Therefore the AMIC believes that this calls for legislative flexibility only offered by a Directive.” In addition to the extra costs arising from substantial new provisions, if a Regulation is put in place, the asset management industry will incur extra costs associated with legal uncertainty. Indeed it is unclear how new regulations will interact with local regulatory frameworks. The AMIC would prefer a well-drafted Directive to allow flexibility.

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Commission asset management priorities

At the September AMIC meeting, members had the opportunity to discuss the European Commission's current priorities as far as the asset management industry was concerned, available in the [Single Market Act](#) presented by Commissioner Barnier. It was explained that a key role had been given to the asset management industry. Among the 12 initiatives in the package, two proposals stood out: a new regulation for the venture capital industry; and another on the financing of social business in Europe. These initiatives clearly identify the asset management industry as part of the solution to the crisis – by being a source of capital to support the real economy.

The European Commission is understood to be working on a proposal for a new legislative proposal (in the form of a regulation) on [venture capital funds](#) to help access to investors in 27 countries through one entry point. These funds would typically be below the AIFMD thresholds and would not be subject to tight rules – but would not benefit from the European passport. The proposal is expected to be lighter than the AIFMD one. The impact assessment is being finalised and should be published before the end of the year.

As far as [the social business initiative](#) is concerned, the aim of the proposal is to reconnect markets with Europe's citizens – one of the Commissioner's key ambitions in his mandate. Social business is a nascent market and it is proving hard to define. A clear distinction is made between "social business" (small and socially useful businesses that may not be profitable) and "social responsibility" (which can be big businesses that have a policy and guidelines on investment). One of the challenges for the European Commission is to calibrate adequately the scope of this proposal to ensure that it is relevant. The impact assessment of the proposal is also being drafted.

The AMIC is interested in the key concepts underlying both proposals, as they touch on the role of the asset management industry in the real economy. The Council will be discussing them in the period ahead.

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Market infrastructure developments

CPSS/IOSCO: Principles for Financial Market Infrastructures

As reported in the [Second Quarter Newsletter](#), on 10 March new and more demanding international standards for payment, clearing and settlement systems were [issued for public consultation](#) by the CPSS and IOSCO. The new standards (called "principles") are designed to ensure that the essential infrastructure supporting global financial markets is even more robust and thus even better placed to withstand financial shocks than at present. They are set out in a consultative report, *Principles for Financial Market Infrastructures* (FMI), which contains a single, comprehensive set of 24 principles, designed to apply to all systemically important payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories (collectively FMIs).

The ICMA ERC responded to this consultation in a [comment letter dated 29 July](#), focusing on considerations from the perspective of repo market practitioners as identified through the input of the ERC Committee and the ERC Operations Working Group. The ERC gave its consideration to each of the 24 principles for FMIs and comments on them sequentially in the annex to this letter, though in some cases it did not find anything to add to the well developed base reflected in this consultation paper. Before coming to those more detailed review points the ERC considered it helpful to emphasise some more general considerations, forming an important part of the backdrop which should be taken into account in formulating the final standards for adoption by FMIs across international markets.

European Commission: Expert Group on Market Infrastructures (EGMI)

In considering the reengineering of the EU's post-trade architecture there are two expert working groups that have been considering what further actions may need to be taken, beyond the series of regulatory actions that is already in progress. These two groups are the EGMI and the Tax barriers Business Advisory Group (T-BAG). The European Commission is holding a conference on 24 October in Brussels to discuss [the road ahead](#) for the European post-trading landscape. This event will provide all stakeholders with a unique opportunity to discuss the policy challenges and legislative initiatives to increase safety, competition and efficiency in this critical area of financial services.

European Commission: European Market Infrastructure Regulation (EMIR)

Published on 15 September 2010, the Commission's EMIR proposal is a Regulation on [OTC Derivatives, Central Counterparties and Trade Repositories](#). Following the standard co-decision procedure, both the Council and the European Parliament (EP) have been continuing their work to determine their positions in respect of this proposal. The aim is that, in line with G20 commitments, the new rules should be fully in place and operational by the end of 2012.

Recent negotiations in the Council have centred on the issues such as the proposed exemption for pension funds, ESMA's powers and access to central bank liquidity, whilst various supposedly more technical issues have been somewhat sidelined. The Council working group sent its EMIR text to the 28 September COREPER meeting, where it was agreed that an agreement would be sought in a Finance Ministers' debate at ECOFIN on 4 October. The European Council then [agreed its position](#), albeit that the compromise proposed by the Presidency allows room for further technical work, in the context of trilogue negotiations with the European Parliament, on how to negotiate and bring into force arrangements with third countries.

ECB: Update on TARGET2-Securities (T2S)

On 29 July a new issue of T2S OnLine (No 9, Summer 2011) was published by the ECB. This issue includes an editorial which highlights the work done by the [Advisory Group](#) and reports on the discussions which took place during its meeting in Bucharest on 30 June and 1 July. Project updates are provided in relation to the Framework Agreement; the Currency Participation Agreement; connectivity; the derogation from CSD eligibility criterion granted to VP Securities; and the signature of the L2/L3 Agreement and payment of the first instalments. There is also an interview on T2S with Hugo Frey Jensen, Governor of Danmarks Nationalbank and a "Bayle's view" article concerning the general approach to T2S user connectivity. Finally there is an article introducing the [Harmonisation Steering Group](#) (HSG), which will support the Advisory Group in formulating and monitoring the T2S harmonisation agenda.

The HSG's First Progress Report to the AG on T2S Harmonisation (dated 13 July) is available, together with a T2S Harmonisation List (rolling version). A second report is planned for November 2011. This first report includes a detailed presentation of the status of each T2S harmonisation activity together with proposals to the AG for further action. The HSG's third meeting took place in Paris on 2 September.

The Business Process Description (BPD) describes and illustrates the business processes for the interaction of CSDs, central banks and other parties that are technically directly connected with T2S. Draft version 0.4, which was [launched on 17 August](#), takes into account the comments received during the June market consultation and formed the basis for the second BPD workshop on 15 September.

From 19-22 September, there have been a number of [T2S events at this year's SIBOS](#) conference in Toronto, more materials in respect of which can be found on the ECB's [T2S website](#). A T2S info session was [held on 12 July](#) in Zurich and the next is to be in Tallinn on 26 October. 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 28-29 September](#) (and next meets on 29-30 November).

In a letter dated 28 September the Bank of England has confirmed to the ECB that it has decided against sterling's participation in T2S. The Bank of England will therefore cease close engagement with the project, albeit that it will continue to follow the project's development. The reasons behind the Bank of England's decision are a belief that the implementation and recurrent costs which would need to be recovered from the UK market are likely to be disproportionate to the benefits; and that the proposal for governance arrangements in relation to non-euro participating currencies falls short of the Bank of England's requirements. Additionally it is clear that there is no consensus within the UK market in favour of sterling participation, notwithstanding that there is continued enthusiasm about initiatives intended to improve the efficiency and robustness of the EU post-trade financial infrastructure.

ECB: Money Market Contact Group

On 5 September the ECB [hosted the latest meeting](#) of its Money Market Contact Group (MMCG). As well as a review of recent market developments, discussions in this meeting were focused on the impact of liquidity regulation on money markets and banks' liquidity management. This discussion was supplemented by: (i) an ECB update on the implementation of Basel III in the euro area; (ii) an ECB summary of the findings of

a questionnaire on this topic; and (iii) a DZ Bank presentation on how the upcoming LCR impacts business models. A Goldman Sachs overview of the changes to the liquidity management in an investment bank had to be postponed to the next meeting due to time constraints. The next meeting is scheduled for 14 December.

ECB: Eurosystem Oversight Policy Framework

On 5 July the ECB issued its [Eurosystem Oversight Policy Framework](#) document. Section 6 of this starts with a segment headed "Interdependencies and location of payment, clearing and settlement systems", within which it says that:

"The Eurosystem has also issued a statement on the location of central counterparties which underlined the Eurosystem's interest in having the core infrastructure that is used for the euro located in the euro area. In applying this statement to the case of over-the-counter credit derivatives, the Eurosystem has stressed not only that there is "a need for at least one European CCP for credit derivatives", but also that, "given the potential systemic importance of securities clearing and settlement systems, this infrastructure should be located within the euro area"."

The absolute and relative size of an offshore CCP's euro-denominated business provides a useful proxy for the potential implications of this CCP for the euro area. The Eurosystem applies thresholds for application of the location policy to CCPs similar to those for payment systems. However, taking into account the specific nature of the CCP business, the threshold of €5 billion applies to offshore CCPs that on average have a daily net credit exposure of more than €5 billion in one of the main euro-denominated product categories. The location policy is applied to all CCPs that hold on average more than 5% of the aggregated daily net credit exposure of all CCPs for one of the main euro-denominated product categories.

This means that CCPs that exceed these thresholds should be legally incorporated in the euro area with full managerial and operational control and responsibility over all core functions, exercised from within the euro area."

More broadly on this topic, which has now attracted significant media attention in light of the UK's legal challenge to the ECB's policy, it is also useful to reference the ECB's website page, [Policy Principle on the Location of Infrastructures](#) (see location policy tab).

CPSS: Red Book

Dated 2 September the CPSS has released volume 1 of a new edition of its reference work widely known as the “Red Book”. The Red Book describes the current payment, clearing and settlement systems in the CPSS countries. This new edition also covers post-trade services more comprehensively than the previous editions, in particular for central counterparties and trade repositories. The Red Book for the CPSS countries was last published in April 2003.

After the enlargement of the CPSS to 24 countries in 2009, this updated edition of the Red Book for the CPSS countries is in two volumes. [This first volume](#) comprises 10 CPSS countries: Australia, Brazil, Canada, India, Korea, Mexico, Russia, Singapore, Sweden and Switzerland. The second volume, which covers Belgium, China, France, Germany, Hong Kong, SAR, Italy, Japan, the Netherlands, Saudi Arabia, South Africa, Turkey, the United Kingdom and the United States and also has chapters on the euro area and international payment arrangements, is planned to be published in 2012.

Separately, on 30 September, the [CPSS has published Statistics on Payment, Clearing and Settlement Systems in the CPSS countries – Figures for 2010 – Preliminary Release](#). This is an annual publication that provides data on payments and payment, clearing and settlement systems in the CPSS countries. This version of the statistical update contains data for 2010 (although some of the data is provisional data for 2010 and some not yet available) and earlier years, with detailed tables for each individual country as well as a number of comparative tables.

Global legal entity identification numbers

As one element of the response to the financial crisis, work is progressing to develop new global legal entity identification (LEI) numbers. Use of such LEIs is one of the elements reflected in the US Dodd-Frank Act and it is anticipated that the US will start the deployment of LEIs (see the US Treasury’s [12 August press release](#) regarding progress and next steps) based on a SWIFT standard (see the [25 July press release](#) from the International Organization for Standardization – regarding ISO 17442), with others expected to follow.

The FSB hosted a workshop on 28-29 September to discuss how to coordinate work on LEI and move the initiative forward. Amongst the key next steps is defining and establishing

the LEI governance structure. There are quite a number of other related resources readily available on the internet, for example through the GFMA’s [LEI “Resources” page](#).

Also, on 24 August [CPSS/IOSCO issued](#) their *Report on OTC Derivatives Data Reporting and Aggregation Requirements – Consultative Report*. This has a section on data aggregation, which after covering LEIs goes on to talk about product classification and then trade identifiers. This is illustrative of the fact that the introduction of LEI is just one step, which needs to be complemented by other common reference data elements if the goal of being able to oversee consolidated global financial market activities is going to be achieved.

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Securities Law Directive consultation

The European Commission has recently published an extended [summary of consultation responses](#) to its consultation on *Legislation on Legal Certainty of Securities Holding and Dispositions* which was published at the beginning of November 2010. The Commission received 108 contributions, one of which was [ICMA’s consolidated response](#), of which Annex 1 represented the views of ICMA’s primary market constituency while Annex 2 reflected the views of the European Repo Committee in respect of the repo oriented aspects of the consultation. The responses themselves have also been published on the Commission’s [website](#). The Commission notes that its initiative to improve the legal framework for holding and disposing securities and the exercise of rights attached to securities in the context of the Internal Market was welcomed by almost all respondents. Respondents confirmed the existence of problems caused by the absence of a harmonised legal framework in at least one of the four areas covered by the consultation. However, there was considerable divergence in views as to how to tackle each of the areas. The next step will be for the Commission to finish preparing a draft Directive on legal certainty of securities holding and transactions.

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Electronic trade confirmations

As reported in our First Quarter Newsletter, ICMA's AMTE Council is actively working to promote electronic trade confirmations. This process is intended to ensure tight control on trading activity through the booking of OTC transactions, and to provide an efficient tool for mitigation of risk and prevention of fraud.

With this objective, and after the *General Recommendation: Trade Confirmation* was issued, the Working Group conducted a short survey on the improvements that have been made lately on electronic trade confirmations in Europe. The survey was sent to various platforms and the following information summarises the responses received:

- *Same-day affirmation:* It appears from the comments of the participants to the questionnaire that no rule book exists to enforce same-day matching. When a recommendation on matching within a limited time after the trade time exists, nothing is planned to enforce this guideline. It is widely accepted by the platforms that the market needs same-day affirmation, and some of them already offer an in-house system. However, the lack of a robust framework to manage trade confirmations of OTC trades – either by the industry or regulators – is very damaging.
- *Definition of best practice:* No best practice agreement for matching transactions is maintained by the respondents; however, all are using different protocols or codes of conduct that cover this issue.
- *Long lasting back-up material:* At least one platform complies with a local regulation that proposes to retain information for a minimum period of five years in a medium which “enables timely provision in electronic format”. In another case, back-up is held on servers, but is not associated with any legal requirement.
- *Compatibility – Use of a standard industry messaging system and creation of a common message description with other platforms:* Some platforms are using a proprietary format while others use the client's own format. Some platforms would potentially support a credible initiative for the issuance of recommendations for each market segment covering open ISO standards, syntax and rules for inter-operability between processes and participants. However, others see no benefit in a convergence of message description or format.

- *Segregation:* Platforms usually offer a wide range of services which include pricing and volume data. Sometimes the option to suppress regulatory reporting on all or selected trades is offered.
- *ARM services:* Some platforms are not compelled to provide any form of regulatory reporting. However, at least one respondent fulfils the regulatory requirements of various regulatory authorities under MiFID. A filtered list of ISIN instruments does not exist. The deployment of such a system that could allow an updated list is currently studied.
- *Expected new regulations for central counterparties:* It appears from the responses received that compulsory use of CCPs for OTC derivatives will drive a higher level of confirmations and interoperability making the choice of a CCP less crucial.
- *Planned links to CSDs and CCPs:* Various projects to feed CCPs have been initiated, but are also subject to upcoming regulation at European level relating to EMIR and T2S.

In addition to its current work, the Electronic Trade Confirmation Working Group is also planning to cooperate with other organisations and will continue the discussions with the regulators, as well as initiate the debate with the European Commission.

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ICMA on Bloomberg and LinkedIn

Bloomberg terminal users can now access the ICMA Quarterly Newsletter and other updates on a dedicated ICMA page. Find our pages on Bloomberg by typing ICMA <GO>. The menu will then give you access to a selection of ICMA's publicly available documents under different headings: Education, Membership, Press etc.

There is also an active ICMA page and discussion group on [LinkedIn](#) (search International Capital Market Association), where we post information about news and events. We have just started an Education subgroup for alumni of our Executive Education courses.

ICMA Events

MiFID review

ICMA will be organising a number of MiFID seminars across Europe from November. For an updated list of events, please visit our [website](#).

4th Annual bwf/ICMA Capital Markets Conference - New Challenges for European Capital Markets, Frankfurt, 24 October

bwf and ICMA jointly present the [4th Annual Capital Markets Conference](#) in Frankfurt, bringing together industry practitioners, regulators and academics to consider developments in the capital markets.

A wide range of topics will be covered during the one day conference, including:

- the future of global securities market regulation
- prices, costs and volumes of trading and post-trading services
- The changing world of exchange trading: the planned merger between Deutsche Börse and NYSE/Euronext
- Role of central and commercial bank money in securities settlement
- Innovations in institutional investor services
- The euro crisis: longer term political and market implications

Swiss Inflation Event, Zurich, 16 November

The Swiss Bond Commission, SIX Swiss Exchange and ICMA present an after work event in Zurich focused on inflation in Switzerland, featuring the following sessions:

- Inflation forecasting within the monetary policy of Swiss National Bank
- Indexing Swiss inflation - An empirical approach
- Inflation bond fund management

Professional Repo and Collateral Management Course, London, 21-22 November

This course has run successfully for over 10 years, becoming the market benchmark. It features a blend of presentations from experienced practitioners who are actively involved in the repo market on a day-to day basis, together with a sound theoretical explanation of the principles involved in this type of financing from ICMA Centre academics. As well as covering the fundamentals of the repo product, the course addresses the uses of repo and collateral by central banks, the impact of the crisis on the repo market and the latest developments in clearing and settlement.

The 2011 ICMA Professional Repo and Collateral Management Course is sponsored by Bondlend.

Global Master Agreements for Repo and Securities Lending Workshop, London, 23-25 November

These two separate master agreements are the essential legal underpinnings for repo and securities lending markets respectively. The workshop will include a detailed review of both legal agreements and their application, together with case studies, the operational and basic legal characteristics of the repo and securities lending markets will also be covered. There will also be a look at the recently published GMRA 2011. The Global Master Agreements for Repo and Securities Lending Workshop is an accredited course under the Solicitors Regulation Authority's (formerly The Law Society) CPD Scheme. Solicitors may claim 18 hours CPD credit for their attendance on the whole course.

Understanding the ICMA Primary Market Handbook (IPMA Handbook), London, 8 December

This half-day session will give an overview of the scope and application of the recommendations and will also review recent developments and changes in the handbook. Understanding the ICMA Primary Market Handbook (IPMA Handbook) is an accredited workshop under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. Solicitors may claim 2.5 hours CPD credit for their attendance at this workshop.

ICMA Annual Ski Weekend, Engelberg, 20-22 January 2012

The 2012 ski weekend, which is a charity event open to ICMA's entire global membership, will be held on the weekend of January 20 to 22, 2012, in the Swiss ski resort of Engelberg.

ICMA AGM and Conference, Milan, 23-25 May 2012

SAVE THE DATE

The 44th ICMA AGM and conference will be held next year at the Palazzo Mezzanotte in Milan. Contact the [ICMA Events team](#) for sponsorship opportunities at discounted rates for members.

For more information on all these events and to register, check the ICMA website.

Contact: taeventsteam@icmagroup.org

ICMA-supported event

Global Investor/isf Swiss Securities Finance & Liquidity Management Forum II Zurich, 27 October

The [Swiss Securities Finance and Liquidity Management Forum II](#) will take place on 27 October at the Zurich Marriot Hotel, Switzerland. This one day conference will give delegates the opportunity to get a first hand understanding of the issues facing the domestic securities lending market and provide a perspective on its role in the cross-border market.

Contact: gievents@euromoneyplc.com

ICMA Executive Education

Register now for these courses

Introductory Programmes

Financial Markets Foundation Course (FMFC)

London: 21-23 November 2011

Luxembourg: 5-7 March 2012

London: 29-31 May 2012

Securities Operations Foundation Course (SOFC)

London: 11-13 October 2011

London: 30 January – 1 February 2012

Intermediate Programmes

International Fixed Income and Derivatives (IFID) Certificate Programme

Next residential courses:

Sitges, Barcelona: 16-22 October 2011

Sitges, Barcelona: 22-28 April 2012

Operations Certificate Programme (OCP)

Brussels: 25-31 March 2012

Primary Market Certificate (PMC)

London: 14-18 November 2011

London: 14-18 May 2012

London: 19-23 November 2012

Specialist Programmes

Corporate Actions – An Introduction

London: 24-25 October 2011

Global Custody

Geneva: 8-9 November 2011

Securities Lending & Borrowing

London: 14-15 November 2011

Operational Risk Fundamentals

Brussels: 8 December 2011

See website for details

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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Glossary

ABCP	Asset-Backed Commercial Paper	ERC	ICMA European Repo Council
AIFMD	Alternative Investment Fund Managers Directive	ESMA	European Securities and Markets Authority
AMF	Autorité des marchés financiers	ESRB	European Systemic Risk Board
AMIC	ICMA Asset Management and Investors Council	FOA	Futures and Options Association
BCBS	Basel Committee on Banking Supervision	ETF	Exchange-traded fund
bps	Basis points	FSB	Financial Stability Board
bwf	Bundesverband der Wertpapierfirmen an den deutschen Börsen e.V.	G20	Group of Twenty
CAC	Collective action clause	ICMA	International Capital Market Association
CBIC	ICMA Covered Bond Investor Council	ICSA	International Council of Securities Associations
CCP	Central counterparty	ICSDs	International Central Securities Depositories
CDS	Credit default swap	IMF	International Monetary Fund
CESR	Committee of European Securities Regulators	IOSCO	International Organization of Securities Commissions
CPSS	Committee on Payments and Securities Settlement	ISDA	International Swaps and Derivatives Association
CRA	Credit Rating Agency	LCR	Liquidity Coverage Requirement (or Ratio)
CRD	Capital Requirements Directives	MiFID	Markets in Financial Instruments Directive
DMO	Debt Management Office	MOU	Memorandum of Understanding
EBA	European Banking Authority	MTF	Multilateral Trading Facility
ECB	European Central Bank	NSFR	Net Stable Funding Requirement (or Ratio)
ECBC	European Covered Bond Council	OTC	Over-the-counter
ECON	Economic and Monetary Affairs Committee of the European Parliament	PRIPs	Packaged Retail Investment Products
ECP	Euro Commercial Paper	RPC	ICMA Regulatory Policy Committee
EFC	Economic and Financial Committee (of the EU)	SBWG	ICMA Sovereign Bonds Working Group
EFSF	European Financial Stability Facility	SGP	Stability and Growth Pact
EGMI	Expert Group on Market Infrastructures	SMPC	ICMA Secondary Market Practices Committee
ESM	European Stability Mechanism	SRO	Self-regulatory organization
EMIR	European Market Infrastructure Regulation	T2S	TARGET2-Securities