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From intensive care to rehabilitation – market practice at the forefront

Foreword by Martin Scheck, Chief Executive of ICMA

This is the last Quarterly Assessment of Regulatory Policy & Market Practice during Hans-Joerg Rudloff's tenure as Chairman of the board of directors of the International Capital Market Association – he is coming to the end of his second three-year term and as set out in the Association's statutes must step down at the forthcoming AGM on 26 May in Paris. Under his guidance, these last six years have seen tremendous change at ICMA as we exited all commercial operations and refocused entirely on our core mission of "improving the efficiency of the cross border securities markets" in our role as a trade association.

We continue to set standards of best practice, standardise documentation, harmonise processes and represent all our members, large and small, buy and sell side, with regulators and policymakers at international and often national levels. I am pleased to say that ICMA is a fundamentally different, more efficient and effective organisation than it was six years ago.

This change has been against the backdrop of the most severe financial crisis most people can remember, where for the last two and a half years the financial markets have been in "intensive care". The causes are well documented and much debated, leading from the subprime crisis, to the credit crisis, then the banking crisis and now also a sovereign crisis in the euro area. These have shown up severe market deficiencies and led on a number of occasions to market breakdowns where it was simply not possible to buy and sell debt securities in a rational manner. Liquidity has been compromised or has been non-existent, and the mechanics of price discovery and trade execution no longer functioned satisfactorily. The crisis also led to nationalisation and bail-outs of systemically important financial institutions (SIFIs) on an unprecedented scale.

Not surprisingly, therefore, the immediate focus has been to ensure that this situation cannot occur again. So we have seen a comprehensive revision of the European regulatory framework and also changes to many domestic regulatory regimes; the creation of the EFSF, and prospectively the ESM; Basel III; the discussions around resolution and "too big to fail"; and a number of other measures. All of these



Martin Scheck

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are designed at a macro level to avoid a similar crisis occurring in the future and to ensure that, if it does, taxpayers are not called upon again to bail out failing financial institutions.

During this period the agenda items garnering most attention, both from regulators and politicians, have been those which deal with the robustness of the financial system and the minimisation of systemic risk: those which relate to market efficiency have not occupied centre stage. Nevertheless the issues are all linked, since much of what is being proposed to make the markets more robust, will also have a (direct or indirect) impact on market practices and market efficiency – a good example being the latest proposals restricting short selling.

ICMA's membership is exceptionally broad both geographically and by type of institution. For many of ICMA's members the efficiency of market practice is of more direct relevance to their day to day business than many of the macroprudential structural reforms. This is where ICMA has been mainly focusing its attention, by analysing the impact of the proposals on the capital market, and ensuring our members' views are heard.

The financial markets are now emerging from "intensive care" and moving into the next phase – "rehabilitation". In this phase, with the support mechanisms now in place (or at least defined), capital ratios and their implementation increasingly clear, and the new European supervisory authorities up and running, I believe that the market's focus is already clearly shifting to market efficiency – ICMA's work on market practice and efficiency will once again take centre stage.

We are already seeing clear evidence of this with our work in the primary markets to improve and make more transparent the new issue processes, the extensive and ongoing work on MiFID, in the repo market the revision of the GMRA 2000 to the GMRA 2011, our work on the transparency of sovereign issuers' terms and conditions and the practical steps needed to implement Collective Action Clauses, as well as the practical work we do with our buy-side committee to improve transparency wherever possible, just to mention a small sample of the ICMA's current work.

Market practice is at the very heart of ICMA – it is part of our DNA. Given the political environment and negative public sentiment towards the financial services sector, which are impacting regulation, there are significant risks that market efficiency is foregone in an attempt to minimise systemic risk. At ICMA we have actively engaged to play our part in ensuring that this balance is optimised and will continue to do so.

Now, the emphasis is shifting from structural support and the robustness of the financial system to ensuring the efficient working of the securities markets. This lies at the very heart of ICMA's mission, and ICMA will play an increasingly meaningful and substantive role in this phase of market repair and development.

We are looking forward to welcoming as many of you as possible at the ICMA AGM and Conference in Paris on 25 to 27 May, where Hans-Joerg Rudloff will be sharing with you his recollections and observations on some aspects of the debt capital markets over the last 40 years.

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Setting standards in the international capital market

One of ICMA's key objectives is to improve market efficiency by setting standards of good market practice in the international capital market. What does this mean and why does it matter?

Market practice

History: The need to set standards of good market practice was the original reason for forming ICMA over 40 years ago. There were settlement problems in the Eurobond market. Market practitioners came together to sort out the problems by setting standards of good market practice.

Coverage: ICMA's standards of good market practice now cover:

- *Primary markets:* The ICMA Primary Market Handbook relates to new issues of syndicated international debt securities; and the documentation for new issues (eg *pro forma* final terms), both in the international bond market and in the short-term Euro Commercial Paper (ECP) market. The Handbook is widely used by syndicate managers, and is continuously updated.
- *Secondary markets:* The ICMA Secondary Market Rules and Recommendations relate to transactions in the over-the-counter cross-border securities market between dealers and their professional counterparties. In a survey of our members last autumn, most respondents confirmed that they use the Secondary Market Rules and Recommendations in the normal course, and that the provisions of greatest importance to them relate to: settlement; the calculation of accrued interest; the value date; buy-ins; and refusal of delivery. The purpose of the usage review was to provide feedback from our members to help ensure that our Secondary Market Rules and Recommendations remain relevant: eg taking account of technological changes in the market and new regulations. Following the review, there are a number of issues which we are proposing, with our members, to address.
- *Repo markets:* The Global Master Repurchase Agreement is widely used cross-border in the repo market, and has recently been updated. ICMA's Legal Department obtains legal opinions each year in over 60 jurisdictions. These cover both the enforceability of the netting provisions of the GMRA as well as the validity of the GMRA as a whole. They also address the issue of re-characterisation risk (in respect of both the transfer of securities and the transfer of margin).

The geographical focus of ICMA's standards of good market practice is in Europe, where most of our members are based. But they are designed to be used for cross-border debt securities transactions much more widely.

Traditionally, ICMA's standards have related mainly to the corporate bond market. But recently, members have also been concerned about the need for standards of good market practice in the sovereign bond market, particularly in the euro area. We conducted a survey of our members at the end of last year to collect their views on the transparency of the contractual terms of sovereign bond issues (which are exempt from the EU Prospectus Directive). Members responding to the survey supported greater transparency of the contractual terms for sovereign bonds, not just for syndicated issuance under English law but for auctioned issuance under national law, which constitutes the bulk of sovereign issuance in the euro area, as well. And following the announcement in November that all bonds issued by sovereign issuers in the euro area would use Collective Action Clauses from mid-2013, we have prepared a revised working draft of the Collective Action Clause in our Primary Market Handbook as a contribution to improving market efficiency.

Member Committees: We rely on the member experts in our Market Practice Committees to help us ensure that our standards address issues of common concern. New market guidance is set whenever there is a market need: eg recently on electronic trade confirmations; and a code of conduct is currently being drafted on the repo market. We also hold roundtables to bring our sell-side and buy-side members together (eg on pre-sounding, bookbuilding and the allocation of new international bond issues, on which we have recently published an explanatory note). We recognise that members have different views. The aim is to find a consensus on common ground.

Competition: Clearly, it is important to note that cooperation among ICMA members to set standards of good market practice is intended to improve the efficiency of the market and should not give rise to any anti-competition concerns. But when we adopt new rules, recommendations and guidance, we typically take external legal advice to check this.

Adherence: ICMA's standards take the form of rules, recommendations and guidance. The rules apply in professional transactions between members unless they opt out. There are proceedings for conciliation and arbitration in the case of disputes, using market experts to enable disputes to be resolved swiftly and in a cost-efficient way. Unlike some other self-regulatory organisations which have powers of enforcement (eg like FINRA in the US), ICMA relies on voluntary adherence to raise standards in the

market. Within our remit as a self-regulatory organisation, we are examining whether there are ways in which we can strengthen adherence to ICMA's standards.

Consistency: ICMA's standards relate primarily to the cash debt securities markets. It is important to ensure consistency between the standard documentation for different parts of the market (eg between ICMA's standard market documentation, ISDA's documentation in the derivatives markets and ISLA's documentation in the securities lending market). The European Financial Markets Lawyers Group, formed under the auspices of the European Central Bank, is taking a particular interest in ensuring consistency between common terms used in different market agreements, as the Group found that, during the international financial crisis, some terms were interpreted in different ways.

Cooperation: ICMA also participates in standard-setting work by other organisations in the international securities market, when invited to do so: the straight-through-processing ("ISMAG") project of the ICSDs (Euroclear and Clearstream) is an example of this. Even though we have not been able to endorse the ICSDs' proposal for Issuer Letters of Representation linked to an Operational Market Practice Book, we have made a constructive contribution to the ISMAG project through agreement on a Guidance Note for our members on *The Provision of Information and Documents to Intermediaries*.

Regulatory framework

Global level: ICMA's standards of good market practice need to be consistent with the regulatory framework. At one level, this is a global issue. IOSCO has for example set *Objectives and Principles of Securities Regulation*, which include recognition of the role of self-regulatory organisations. IOSCO is also consulting stakeholders on the role of securities regulators in reducing systemic risk through:

- promoting transparency in markets and products;
- robustly regulating supervision of business conduct so as to manage conflicts of interest and prevent distorted incentives in the financial system;
- focusing on financial innovation and its implications for financial stability;
- improving the overall understanding of the economics of the securities markets, their weaknesses and links with the broader financial sector and the real economy; and
- developing key risk measures relevant to systemic risk within the securities markets.

EU level: For ICMA members in the European Economic Area, the regulatory framework is set largely at EU level through EU Regulations (which apply directly in EU Member States) and EU Directives, which have to be transposed into national law. New EU legislation is proposed by the European Commission, but also has to be agreed by the European Parliament and the 27 EU Member States. Besides the impact of the Capital Requirements Directives on market firms, the key EU legislation in the securities markets includes:

- the Prospectus Directive, the Transparency Directive and the Market Abuse Directive in the primary markets;
- the Market in Financial Instruments Directive (MiFID) and the Short Selling Regulation in the secondary markets;
- UCITS and the Alternative Investment Fund Managers Directive in asset management; and
- the proposed European Market Infrastructure Regulation (EMIR).

Some of these legislative measures – such as the Prospectus Directive and MiFID – are currently under review, while others – such as EMIR – are being newly proposed.

Within EU legislation, the European Securities and Markets Authority (ESMA), which took over from the Committee of European Securities Regulators at the beginning of this year, has been granted binding powers to create a Single EU Rule Book for the securities markets. These powers include the following:

- In particular areas specified in EU legislation, ESMA will draft "regulatory technical standards" and "implementing technical standards" that will be legally binding in EU Member States.
- ESMA will also issue guidelines and recommendations with which national authorities need to comply within two months or explain why they have not done so; and require financial market participants to report in public whether or not they comply.
- ESMA will be able to prohibit financial products that threaten financial stability or the orderly functioning of financial activities for three months, and a more general power to ban financial activities in an emergency.
- ESMA has the ability to launch a fast track procedure to ensure the consistent application of EU law in Member States.
- ESMA has new powers to resolve disagreements between national authorities.
- ESMA will also be able to collect financial information to help the European Systemic Risk Board assess systemic risk.

National level: Besides ESMA’s role in creating a Single EU Rule Book, there is also a continuing interest in setting standards at national level. For example, the UK Government has recently set out the role of the proposed new UK Financial Conduct Authority, and states that: “Conduct of business regulation has a fundamental role to play in protecting and enhancing ... confidence in the UK financial system: first, in setting out the standards to which firms are expected to adhere; and second, in monitoring and enforcing compliance with those standards.”

Impact of regulation on market efficiency

There are two reasons why regulation of the cross-border securities markets is of particular importance to ICMA members at present. The first is that regulation is changing substantially in response to the crisis: not just prudential regulation, but also regulation of the conduct of business, while the perimeter of regulation is being broadened. The second reason is that regulation since the crisis has become much more extensive. One of the reasons given by some regulators for more extensive regulation is that the market has not been able to deliver sufficient improvements itself, and so it needs to be more heavily regulated.

ICMA’s role here on behalf of members is two-fold: first of all, making sure as far as possible that new regulations help to improve market efficiency rather than the reverse. Dialogue between the market and regulators is one way of doing this. Another is responding to regulators’ consultations on their new proposals. Often responses to consultations have to be prepared very quickly. Because of the political imperative to introduce new legislation as quickly as possible, the European Commission often does not give the market as much time as it would like to prepare a considered response; and the Commission does not always itself have sufficient time to take responses fully into account, before making a legislative proposal. As a result, more time is needed to amend the legislation later, before agreement can be reached with the European Parliament and the EU Member States. There is also a risk that new securities legislation is developed in separate “silos”, and is not fully consistent with other overlapping legislation which also affects member firms. These problems can be reduced if ICMA is able to become engaged at an early stage in the legislative process, so that we are proactive rather than reactive.

Second, when new EU legislation affecting the cross-border securities markets has been finalised, member firms have to implement it, often against a tight deadline. For member firms, this can be a substantial task, both in terms of the

commitment of time required and the related cost (eg in terms of IT changes). Industry guidance can sometimes be useful in helping firms to take a common – and cost-effective – approach to implementation. This was the case with the MiFID Connect guidance to help firms implement MiFID before it was originally introduced in November 2007. Similar questions may arise as a result of the fundamental review of MiFID that is likely to lead to a new proposal by the Commission for legislation this summer.

Relationship between market practice and regulation

There is a very close relationship between new regulations and standards of good market practice, as new regulations can change market standards, and good market practice may obviate the need for new regulations. So we need to deal with both in our Market Practice Committees: eg the impact of the review of the Prospectus Directive on our Primary Market Handbook; and of MiFID, the Short Selling Regulation and the European Market Infrastructure Regulation in the secondary market, the repo market and the ECP market.

Member involvement

A large number of our member firms are already involved in our work in setting standards of good market practice in the cross-border debt securities markets. If you are not already involved, and would like to be, please let us know at regulatorypolicy@icmagroup.org.

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Recent practical initiatives by ICMA

Sovereign bond markets

1. We have provided feedback to members on the responses we received to the ICMA Sovereign Bond Consultation Paper. In their responses, members supported a call for greater transparency in the contractual terms of sovereign bond issues (as opposed to seeking changes in the contractual terms themselves).
2. Taking account of the Eurogroup's recent decision to include Collective Action Clauses (CACs) in all bond issues by euro-area sovereign issuers from mid-2013, we have prepared an example of what a euro area CAC might look like in the light of the standard CAC in our Primary Market Handbook. We are grateful for substantial *pro bono* help from Clifford Chance.
3. We have finalised guidance on buybacks by EU sovereign and sovereign agency issuers and by supranational issuers, in consultation with our AMTE Council.

Short-term markets

4. In the light of changes to the ECB's collateral rules, the ICMA ECP Committee has been in contact with a few key exchanges in the euro area to review their respective ECP listing requirements.
5. On behalf of the ICMA ERC Committee, we have written to Pascal Canfin, MEP, and others regarding Article 13 of the Short Selling Regulation.
6. The ERC Committee has informed the World Gold Council that the ERC is willing to endorse its letter to the Commission requesting that gold be classified as a "highly liquid asset" under the Capital Requirements Directive (CRD) IV.
7. An ICMA Repo Code of Conduct is being drafted by Richard Comotto for approval by the ERC Committee.
8. A further update of the ERC White Paper has been published.
9. The ERC and European Primary Dealers Association (EPDA) have written jointly to the Greek DMO on the development of a repo facility.

Primary markets

10. Michael Gower of Rabobank has been appointed as Chairman of the recently established ICMA Issuer Forum.

11. The ICMA Legal & Documentation Committee has written a further letter to the UK Treasury following its consultation on *A New Approach to Financial Regulation: Judgement, Focus and Stability*. The letter emphasises the need for the future UK Financial Conduct Authority (previously called the Consumer Protection and Markets Authority) to balance appropriately its "consumer" and "markets" responsibilities.
12. With our members, we have been meeting national regulators on the European Securities and Markets Authority's (ESMA's) work on Level 2 of the review of the Prospectus Directive. We are preparing an updated version of the ICMA *Model Form Selling Restrictions* to reflect the recent publication of amendments to the Prospectus Directive.
13. We have submitted a response to ESMA's call for evidence on the European Commission's request for technical advice on possible delegated acts concerning the Prospectus Directive.
14. Through our active involvement on the retail structured products' Joint Associations Committee, we have submitted a response to the European Commission's consultation on its Packaged Retail Investment Products Initiative and to some aspects of MiFID.
15. Drawing in particular on views expressed from issuer and investor members' perspectives, we have commented on the senior unsecured debt "bail-in" proposals made by the European Commission as part of its work on a European crisis resolution framework.
16. As part of our Usage Review, we are considering whether to propose a restructuring of the ICMA Primary Market Handbook (previously the IPMA Handbook) to the ICMA Legal & Documentation Committee, chaired by Kate Craven of Barclays Capital.

Secondary markets

17. We have responded on behalf of our members to the European Commission consultation on the review of MiFID, including input from both our primary and secondary market members, and we are coordinating closely with other trade associations, including AFME, ISDA and FOA. Work continues on tracking new developments at EU level and establishing common industry positions ahead of the publication of the Commission's legislative proposals.

Recent practical initiatives by ICMA – continued

18. In addition to the MiFID events we held with, and for, members in Zurich, Luxembourg and Milan at the end of last year, we held further MiFID events in Frankfurt and Paris in March, in collaboration with ISDA.
19. As part of our Usage Review, we have held a meeting with respondents to our member survey on usage of the ICMA Secondary Market Rules and Recommendations and on their suggestions for keeping it up to date. These will now be considered in more detail in our Secondary Market Practices Committee.
20. We are reconstituting our Secondary Market Practices Committee to make sure that our Secondary Market Rules and Recommendations are as relevant as possible to members; and to help them prepare for the implementation of new regulatory changes in a cost-effective manner.

Asset management

21. The ICMA Asset Management and Investors Council (AMIC) has commented on ESMA's call for evidence on the Alternative Investment Fund Managers Directive, and in particular explained the role of alternative funds in diversified investment strategies.
22. In response to the European Commission's consultation on over-reliance on Credit Rating Agencies (CRAs), the AMIC has argued that, although over-reliance on CRAs was one of the causes of the financial crisis, the solutions proposed are difficult to implement: CRAs continue to have a key role to play for investors in the international capital market.
23. The AMIC has publicly supported the Financial Reporting Council's *Stewardship Code*, which encourages investors to publish a statement on their website on the extent to which they have complied with the Code.
24. The Covered Bond Investor Council (CBIC) is expecting to put forward proposals on the transparency of all covered bond issuance on a national basis.
25. With the help of our Private Banking Working Group, we are planning to organise a cross-border private banking conference for our members and others in Luxembourg in October.

Market infrastructure

26. We are supporting Godfried De Vidts, Chair of the ICMA ERC Committee, who is participating in the European Commission's Expert Group on Market Infrastructure (EGMI) to represent our members' interests, especially – but not only – in the repo market, and to seek to ensure that EGMI's recommendations take account of the specific needs of our markets.
27. The ICMA ERC has commented on the repo-oriented aspects of the European Commission's consultation on technical details underpinning its proposed crisis resolution framework, particularly including a proposed temporary stay on rights to close-out netting.
28. The ICMA ERC has commented on the repo-oriented aspects of the European Commission's consultation on common rules for Central Securities Depositories (CSDs) and the harmonisation of certain aspects of securities settlement.
29. The ICMA ERC has commented on the repo-oriented aspects of the European Commission's consultation on the harmonisation of securities law, which contemplates legislation on the legal certainty of securities holding and dispositions.
30. With the agreement of a Working Group of our AMTE Council, we have introduced a new recommendation on electronic trade confirmations into our Secondary Market Rules and Recommendations.
31. The ICSDs (Euroclear and Clearstream) have put forward their proposals for Issuer Letters of Representation linked to an ICSD Market Practice Book. ICMA has observer status on the ISMAG, which the ICSDs consult on the project. ICMA has previously endorsed a *Guidance Note on the Provision of Information and Documents to Intermediaries*.
32. ICMA has been liaising with the two ICSDs on the proposed mandatory extension of the EPIM system for ISIN allocation to MTN issuance from 1 July (initially 1 February) and the serious challenges faced by banks in establishing relevant systems in time.

G20 financial regulatory reforms

The Financial Stability Board (FSB) [has issued a report to the G20](#) on progress in implementing global financial reforms. Following from the Paris meeting of G20 Finance Ministers and Central Bank Governors, held 18-19 February, a [communiqué has been issued](#). With respect to regulatory reforms, point 6 of this is pertinent. In brief it states the following:

- We commit to pursuing the reform of the financial sector, but significant work remains.
- We will implement fully the Basel III new standards for banks within the agreed timelines.
- We will implement the FSB's recommendations on OTC derivatives and on reducing reliance on CRAs' ratings.
- We look forward to the completion by the next Leaders' summit of ongoing work on SIFIs.
- We look forward to the 2 reports to be finalized by the BIS, IMF and FSB on macroprudential frameworks; and by the FSB, IMF and World Bank with input of national authorities on financial stability issues in emerging market and developing economies by our October meeting.
- We look forward to the recommendations that the FSB will prepare by mid-2011 on regulation and oversight of the shadow banking system.
- We call on IOSCO to develop by mid-2011 recommendations to promote markets' integrity and efficiency notably to mitigate the risks created by the latest technological developments.
- We also call on the FSB to bring forward for our next meeting comprehensive proposals to strengthen its governance, resources and outreach.
- We urge all jurisdictions to fully implement the FSB principles and standards on sounder compensation practices.
- We call on the OECD, the FSB and other relevant international organizations to develop common principles on consumer protection in the field of financial services by our October meeting.
- And we reaffirm our commitment to more effective oversight and supervision, including regular stress testing of banks building on the Basel committee's principles.

A letter has been sent by the Chairman of the IOSCO Technical Committee, Hans Hoogervorst, to the FSB. This introduces a recently published IOSCO Technical Committee Discussion Paper

on *Mitigating Systemic Risk – A Role for Securities Regulators*. This paper aims to promote discussion on the ways in which systemic risk intersects with the mandate of securities regulators and to provide insight into how IOSCO and securities regulators can identify, monitor, mitigate and manage systemic risk. It concludes that securities regulators have a key role to play in identifying and mitigating systemic risk – a responsibility they share with central banks and prudential regulators, which have traditionally been the focal point for stability of the overall financial system. IOSCO has established a research function to focus on emerging sources of systemic risk and produce a *Global Securities Regulation Risk Outlook*, building on and complementing the work of bodies such as the IMF.

Dated 3 March, the FSB made available a 14 February update to G20 Finance Ministers and Central Bank Governors, regarding [macroprudential policy tools and frameworks](#). This update summarises the work underway internationally and nationally to develop effective macroprudential policies and frameworks, by drawing also on surveys conducted by the BIS (via the CGFS) and IMF. These efforts include regulatory reforms and the design of policy tools to strengthen the resilience of the financial system, as well as efforts at the national and regional level to develop fully-fledged macroprudential policy frameworks. An annex discusses issues related to managing capital flows. This note finds that major steps have already been taken. That said, further work is needed to address the remaining challenges in successfully implementing macroprudential policies and institutional frameworks, including:

- design and collection of better information and data to support systemic risk identification and modelling;
- design of techniques to identify and measure systemic risk that utilise this information and help inform the design of policies;
- design of an effective macroprudential toolkit of powers and instruments, including the criteria for the choice and calibration of the instruments and methods to assess their effectiveness, as well as the respective merits of rules versus discretion; and
- design of appropriate governance arrangements for the exercise of the macroprudential policy powers.

The FSB, BIS and IMF will provide an update on progress in these areas to G20 Leaders at their November meeting.

As reported in its [5 April press release](#) the FSB met in Rome, reviewing vulnerabilities in the financial system and key financial regulatory reforms.

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European reform of financial supervision

At the inaugural meeting of the [European Securities and Markets Authority \(ESMA\)](#) Board of Supervisors (BoS) on 11 January, Carlos Tavares was elected Vice-Chairman of ESMA. Tavares, the Chairman of the Portuguese CMVM, had already chaired CESR from July to December 2010 and served as Vice-Chairman since February 2009. At the same meeting, members of ESMA's BoS also set up the Management Board (MB) of ESMA by electing its first six members.

Similarly, the European Insurance and Occupational Pensions Authority (EIOPA) had its [first meeting on 10 January](#), electing Victor Rod, Director of the Commissariat aux Assurances, Luxembourg, to be EIOPA's Vice-Chairperson; and the European Banking Authority (EBA) [had its first meeting](#) on 12 January, appointing Thomas Huertas, Director at the UK FSA, as the EBA Alternate Chairperson.

On 13 January, [ESMA announced](#) the selection of Steven Maijor (Director at the Netherlands Authority for the Financial Markets), as the proposed first Chair of ESMA. Similarly the [EBA announced](#) Andrea Enria (head of the Supervisory Regulations and Policies Department at the Bank of Italy) as the EBA Chairperson; and the [EIOPA selected](#) Gabriel Bernardino (Director General of the Directorate for Development and Institutional Relations at the Instituto de Seguros de Portugal) as EIOPA Chairperson. All these selections were subject to confirmation by the European Parliament (EP).

On 1 February, members of the EP's ECON Committee duly held hearings with the selected candidates for the positions of Chairmen of the European Supervisory Authorities (ESAs). This was followed by an [ECON press release](#) regarding the postponement of a decision on the three candidates. On 3 February MEPs, however, [withdrew their reservations](#) regarding the nomination of the three candidates. The EP sought and managed to obtain reassurance in four areas: independence of the authorities; Board representation; adequate budgetary resources; and appointment procedure.

On 22 February, ESMA announced that [Verena Ross had been nominated](#) for the post of ESMA's first Executive Director. The Executive Director will be entrusted with the day-to-day management of ESMA. According to the Regulation establishing ESMA, the Executive Director will serve a term of five years, renewable once. Similarly on 28

February the EIOPA announced that [Carlos Montalvo had been selected](#) to serve as the first Executive Director of the EIOPA; and on 2 March the EBA announced that [Adam Farkas had been selected](#) to serve as the first Executive Director of the EBA. Following 17 March open hearings at the EP, all these appointments were confirmed in EP plenary votes on 24 March – as announced by [ESMA](#); the [EBA](#); and the [EIOPA](#).

The [General Board](#) of the European Systemic Risk Board (ESRB) [held its inaugural meeting](#) on 20 January. The meeting led to a number of decisions on the set-up and functioning of the Board:

- The ESRB [rules of procedure](#) were established.
- Mr Marek Belka, Governor of the Narodowy Bank Polski; Mr Mario Draghi, Governor of the Banca d'Italia; Mr Athanasios Orphanides, Governor of the Central Bank of Cyprus; Mr Axel Weber, President of the Deutsche Bundesbank; were elected members of the [Steering Committee](#) for three years.
- Mr Stefan Ingves, Governor of the Sveriges Riksbank was elected Chair of the Advisory Technical Committee for three years.
- Mandates for the [Advisory Scientific Committee](#) and the [Advisory Technical Committee](#) were adopted.
- The General Board decided to approve the [procedures to select the members](#) of the Advisory Scientific Committee and to publish a [call for expressions of interest](#) for membership of the Committee.

The Chair of the ESRB is the President of the European Central Bank, Mr Jean-Claude Trichet and the first Vice-Chair of the ESRB is Mr Mervyn King, Governor of the Bank of England, who was [elected by the members of the General Council](#) of the ECB on 16 December 2010 for five years (the second Vice-Chair of the ESRB will be the Chair of the Joint Committee of the European Supervisory Authorities).

Following from its 20 January inaugural meeting, the General Board of ESRB [held its first regular meeting](#) on 18 March. The General Board discussed in broad terms risks and vulnerabilities of a systemic nature in the European Union.

In addition, the General Board:

- explored the role the ESRB could play in implementing countercyclical capital buffers;
- discussed the interaction between the ESRB and the EU institutions;
- considered how the ESRB will be fully involved in the ESA's stress tests; and
- assessed progress in the preparations for agreements on the exchange of information between the ESRB and the ESAs.

Finally, the General Board completed the institutional framework of the ESRB by establishing [the ASC](#). The General Board plans to hold a press conference on 22 June, after its next meeting, to report on ESRB activities in the first half of 2011.

Dated 19 January, the European Commission [published an additional legislative proposal](#) to complete the framework for financial supervision in Europe – the anticipated “Omnibus II”. This covers amendments to the Solvency II Directive for the insurance sector ([Directive 2009/138/EC](#)) and parts of the Prospectus Directive ([Directive 2003/71/EC](#)), to further precise the scope for the ESAs to exercise certain of their new powers. Omnibus II is being actively debated, with Presidency compromise texts already circulating; and the EP's ECON committee held a first exchange of views on 21 March.

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The role of the European Securities and Markets Authority

Established through the transformation of the Committee of European Securities Regulators (CESR) as from 1 January, the [European Securities and Markets Authority](#) (ESMA) is an independent European Union (EU) Authority that contributes to safeguarding the stability of the EU's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as enhancing investor protection.

Governance of ESMA

Steven Maijor (previously a Director at the Netherlands Authority for the Financial Markets) is the [first full-time Chair](#) of ESMA, based at ESMA's premises in Paris. This is a significant change as under CESR, the Chair was one of its members and therefore based in his/her respective home country as they were in charge of one of the national supervisors. The Chair will not be representative of any Member State or an appointee of the European Commission. Under the new framework, the Chair is responsible for preparing the work of the ESMA Board of Supervisors (BoS) and chairs both the meeting of the BoS and the ESMA Managing Board (MB). She/he does not vote in the BoS.

The other key management role is the Executive Director (ED) of ESMA. This role will be [taken up by Verena Ross](#) (currently the director of the UK FSA's International Division). The ED will be responsible for ESMA's day-to-day running, including drawing up and implementing the annual work plan and budget, and managing the Authority's staff.

The Chair and the ED of the ESMA took up office on 1 April. They will both serve a five year term which may be extended once.

Finally, there are principally two bodies in ESMA's governance structure. These are the BoS, which brings together the [heads of the 27 Member State competent authorities](#) and the MB. The BoS' main role is to take all policy decisions of ESMA. The BoS also takes the final decision on ESMA's budget. The BoS meets twice a year. Each of the Commission, the ESRB and the other two ESAs provide one non-voting representative member. The default case is that the BoS take decisions by simple majority, though rules, guidance and the budget are decided by qualified majority voting.

The role of the European Securities and Markets Authority - continued

Elected by ESMA on 11 January, the MB's first six members, are: Karl-Burkhard Caspari, BAFIN, Germany; Jean Guill, Commission de Surveillance du Secteur Financier, Luxembourg; Alexander Justham, Financial Services Authority, UK; Raul Malmstein, Finantsinspeksioon, Estonia; Kurt Pribil, Finanzmarktaufsicht, Austria; and Fernando Restoy, Comision Nacional del Mercado de Valores, Spain. Together with the Chair, these six comprise the MB – the ED and the Commission also being non-voting representatives. The main role of the MB is to focus on the management aspects of the ESMA, such as the development of a multi-annual work programme, the budget and staff resources.

Powers and roles of ESMA

At the aftermath of the financial crisis it was noted that, despite the fact that financial institutions operate across borders using the single EU market, supervision had remained mostly at the national level; was uneven; and often uncoordinated. Accordingly, in addition to continuing the work of CESR, ESMA will have new competencies and powers, which include:

- *Direct supervision:* Whilst day-to-day supervision broadly remains the responsibility of national supervisors, in a limited number of cases, where there is clear added value to EU-level supervision, ESMA may be asked to supervise pan-European entities. Currently, ESMA's direct supervisory power concerns Credit Rating Agencies (CRAs). It is likely that new EU legislation may grant further supervisory powers to ESMA, for example in the case of trade repositories.
- *Rule-making and guidelines:* ESMA will draft “regulatory technical standards” and “implementing technical standards” in areas specified by the sectoral directives, which will be adopted by the Commission as regulations and decisions, ie EU laws which are directly applicable. ESMA will also issue guidelines and recommendations which national competent supervisors must treat as “comply or explain”. ESMA's work on securities legislation will contribute to the development of a Single Rule Book in Europe which will include rules both for supervisors and for firms.
- *Banning financial activities:* ESMA will have additional responsibilities for consumer protection. These include the ability to prohibit financial products that threaten financial stability or the orderly functioning of financial markets for a period of three months; alongside the wider ability to ban financial activities. In normal situations this will only be allowed in areas specified in sectoral directives and according to procedures set out in that legislation. In emergency situations ESMA will have a more general power to ban financial activities.
- *Investigations:* ESMA has the ability to launch a fast track procedure to ensure consistent application of EU law. A fallacy of the previous regulatory framework was the fact that, if a Member State failed to apply properly a national provision in EU legislation, either due to a difference in interpretation, or because it was lacking technical capacity nationally or simply because it did not want to implement legislation, the sole remedy was for the Commission to take the Member State to the European Court of Justice – which can take a number of years. Under the new regulatory framework, instead, ESMA can require the national competent authority to provide it with all information it deems necessary.
- *Emergency powers:* As soon as the European Council declares an emergency, the first objective of ESMA is to facilitate and coordinate actions by national supervisors, though without taking binding decisions. ESMA can also take decisions binding on supervisors or firms, but only to ensure compliance with EU law; and has a broad power to ban financial activities.
- *Binding mediation:* ESMA has new powers in resolving disagreements between national authorities. Whilst CESR used to have a mediation mechanism through which to settle sectoral disputes, ESMA acts first as mediator. In the event that this does not work, ESMA is allowed to issue binding decisions requiring the competent authorities to take specific action to settle the matter, but only to “ensure compliance with EU law”. ESMA, however, cannot displace lawful exercise of a competent authority's discretionary judgement, but breach of law may be in regard of either procedure or content of a supervisory decision.

The role of the European Securities and Markets Authority - continued

- *Colleges:* ESMA has a role to promote and monitor efficient, effective and consistent functioning of colleges of supervisors, including participating in on-site inspections carried out jointly by two or more competent authorities.
- *Peer review:* ESMA is in charge of organising and conducting peer review analyses to strengthen consistency of “supervisory outcomes”. This includes: (i) adequacy of resources and governance arrangements of national authorities; (ii) convergence in application of EU law; (iii) good practices; and (iv) effectiveness and convergence of enforcement provisions (including sanctions).
- *Information gathering:* ESMA has a general power to collect information, in particular with the purpose of monitoring systemic risk of cross-border financial institutions, while contributing to the work of the European Systemic Risk Board (the ESRB – which is the new EU body responsible for identifying systemic risk).
- *Other more general tasks:* ESMA may undertake other tasks, including: (i) assessment of market developments; (ii) a role in the prudential assessment of acquirers in mergers and acquisitions; (iii) various consumer protection objectives; and (iv) international role/engagement.

ESMA's top priorities

ESMA has presented in its [work programme for 2011](#). This includes 38 top priorities, identified in section 1 of the work programme, which fall under three heads:

- establishment of ESMA;
- Alternative Investment Fund Managers Directive; and
- European Market Infrastructure Regulation.

In section 2 of ESMA's 2011 work programme there are 102 further items relating to the work of ESMA's panels, permanent standing committees, task forces, support groups and networks. Section 3 covers 12 ESMA staff work items and another 28 items in respect of the 3L3 (combined) work streams.

ESMA's public statement of consultation practices

Dated 11 January, ESMA has produced a public statement on its [consultation practices](#). This outlines its views on the purpose of consultation and the guiding principles it uses to consult. In an annex it also elaborates on a number of groups and networks used for consultation by ESMA in addition to its public consultation. In particular, these include the Securities and Markets Stakeholder Group, Consultative Working Groups and a Retail Investor Network.

ICMA's engagement with ESMA

Particularly given ICMA's focus on cross-border securities markets, ESMA is a key interlocutor. ICMA has previously established strong relationships across all levels of CESR and is working not just to carry these across to ESMA, but also to further develop them. Starting at the very top, this includes inviting the ESMA Chairman to deliver a key note speech at the ICMA's annual conference in Paris at the end of May. As well as working directly with ESMA, ICMA is also carefully fostering its ongoing relationships with the key national supervisory authorities represented in the ESMA BoS.

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Crisis management

Following from the Commission's 20 October [Communication on Crisis Resolution](#), on 6 January, the European Commission [launched a consultation](#) on technical details underpinning that framework. This new consultation should be read in conjunction with the earlier Communication. The Commission intends to come forward with a legislative proposal for a comprehensive framework for dealing with failing banks before the summer of 2011. The deadline for contributions to this consultation was 3 March.

The possible options set out in this consultation would constitute a significant step for the EU in delivering the commitment made at the G20 summit in June 2010, by ensuring that authorities across the EU have the powers and tools to restructure or resolve (the process to allow for the managed failure of the financial institution) all types of financial institution in crisis, without taxpayers ultimately bearing the burden. They are also consistent with the principles for ensuring that resolution is a viable option for systemically important financial institutions that are being developed by the Financial Stability Board. This consultation focuses on measures for banks and investment firms. The Commission will report by the end of 2011 on appropriate measures for other kinds of financial institution, including insurers and central counterparties.

The overriding objective will be to ensure that banks can be resolved in ways which minimise the risks of contagion and ensure continuity of essential financial services, including continuous access to deposits for insured depositors. The framework should provide a credible alternative to the expensive bank bail-outs which have characterised the recent crisis. The consultation asks stakeholders their views on the effectiveness of these possible powers and tools:

- Effective arrangements which ensure that authorities coordinate and cooperate as fully as possible in order to minimise any harmful effects of a cross-border bank failure. It is suggested to build on existing supervisory colleges, expanding them to include resolution authorities for the purposes of crisis preparation and management. The consultation seeks views from stakeholders on the most appropriate framework to ensure an effective resolution of cross-border groups.

- Fair burden-sharing by means of financing mechanisms which avoid use of taxpayer funds. This might include possible mechanisms to write down appropriate classes of the debt of a failing bank to ensure that its creditors bear losses. Any such proposals would not apply to existing bank debt currently in issue. It also includes setting up resolution funds financed by bank contributions. In particular the consultation seeks views on how a mechanism for debt write down (or "bail-in") might be best achieved, and on the feasibility of merging deposit guarantee funds with resolution funds.

ICMA has [responded to this consultation](#), confining its comments to those questions laid out in Annex A of the consultation, being those related to the proposed senior unsecured debt bail-in mechanism. This response has been compiled in light of a range of inputs provided by ICMA's member firms, including representations made from both issuer and investor perspectives. As such it presents a synthesised view informed by both ends of the value chain – ie those firms that issue the senior unsecured debt potentially impacted by the contemplated bail-in regime; and those firms that invest in such debt instruments. ICMA considers that this provides a well informed, broadly based view of the proposals.

The response comprises two segments. First, it lays out some overall thoughts regarding the concept of a bail-in regime applicable to senior unsecured creditors. Moving on from this, it then sequentially addresses each of the specific questions posed in Annex A of this consultation. Whilst being supportive of the Commission's endeavours, the ICMA perceives that there are nevertheless some significant overriding challenges which will need to be overcome in the final design of any such senior unsecured debt bail-in regime. The response also stresses that other measures to increase the quality and quantity of capital, and the stability of the financial system should be completed before bringing in a bail-in regime; and that it is essential that equity and all other capital instruments are fully wiped out before any senior unsecured debt bail-in applies. The ICMA ERC also responded to specific technical element of this consultation, as described in the repo section of this Newsletter.

On 18 January, ESMA [issued a press release](#), concerning a [mapping exercise](#) launched under CESR in order to provide a better understanding on how national authorities in the financial sector across Europe, are equipped to deal with

emerging crises and apply contingency measures available to them at national level, in times of financial crisis. The main conclusion of this mapping, carried out in 2010 is that it is unlikely that national authorities could address a crisis on a common or comparable legal basis and accordingly act in a fully coordinated way in a crisis. The availability of powers for national authorities in a crisis, with respect to the different areas of securities regulation, is diverse throughout Europe; the nature and scope of their contingency powers as well as the legal conditions governing their exercise differ significantly. The availability of powers that might need to be applied in a crisis generally has not been assessed throughout the national authorities in the financial sector before.

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Capital requirements

As reported in the [First Quarter Newsletter](#), on 16 December, the Basel Committee on Banking Supervision (BCBS) issued the Basel III rules text, which presents the details of global regulatory standards on bank [capital adequacy](#) and [liquidity](#). Under date of 23 February, the BIS has [made available a working paper](#) regarding Basel III's long-term impact on economic performance and fluctuations. On 20 December, the BCBS [issued a consultative paper](#) on the capitalisation of bank exposures to central counterparties and on 9 February the European Commission [launched a public consultation](#) seeking stakeholders' views on related matters (this is discussed in more detail in the repo section of this Newsletter).

On 13 January, the BCBS [issued](#) minimum requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss. These requirements were endorsed by the BCBS's oversight body, the GHoS, at its 10 January meeting. Members agreed that under certain conditions, including a peer review process and disclosure, the proposal's objective could be met through a statutory resolution regime if it produces equivalent outcomes to the contractual approach. In order for an instrument issued by a bank to be included in Additional (ie non-common) Tier 1 or in Tier 2 capital, it must meet or exceed minimum requirements set out in an annex. These requirements are in addition to the criteria detailed in the Basel III capital rules that were [published in December 2010](#).

Under date of 11 February, the BCBS has published revisions to the Basel II market risk framework. The document has been updated as of 31 December 2010 to reflect the adjustments to the Basel II market risk framework announced by the BCBS in its [18 June 2010 press release](#) and the stress testing guidance for the correlation trading portfolio referred to in paragraph 9 of the [July 2009 version of this document](#). Changes introduced by the Basel III framework are not yet reflected in the text. In the separate document, *Interpretative Issues with respect to the Revisions to the Market Risk Framework*, the BCBS provides responses to [interpretative issues regarding the revisions to the Basel II market risk framework](#) and the guidelines for computing capital for incremental risk in the trading book. Updated versions of this document will be published on the BCBS's website if and when additional interpretative issues arise.

Broadly reflective of the Basel III agreements, the European Commission's upcoming amendment to the Capital Requirements Directives is now expected to be proposed in the second quarter of 2011.

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OTC (derivatives) regulatory developments

As reported in our previous Newsletters, on 15 September, the Commission [adopted a Regulation on OTC Derivatives, Central Counterparties and Trade Repositories](#). An update relating to this, so called, EMIR proposal, is included in the market infrastructure segment of this Newsletter.

Under cover of its [18 February press release](#), IOSCO has released its [Report on Trading of OTC Derivatives](#), which analyses the benefits, costs, and challenges associated with increasing exchange and electronic trading of over-the-counter (OTC) derivatives products and contains recommendations to assist the transition of trading in standardised derivatives products from OTC venues onto exchanges and electronic trading platforms (organised platforms) while preserving the efficacy of those transactions for counterparties.

The report concludes that it is appropriate to trade standardised derivatives contracts with a suitable degree of liquidity on organised platforms, and that a flexible approach to defining what constitutes an organised platform for derivatives trading would maximise the number of standardised derivatives products that can be appropriately traded on these venues. It identifies characteristics that an organised platform should exhibit in order to fulfil the G20 Leaders' objectives, as well as the benefits and costs associated with transitioning trading of derivatives from OTC venues onto organised platforms. It also presents a range of actions that regulators may choose to take to increase organised platform trading of OTC derivatives products.

Assuming that product standardisation has increased, that central clearing is used for OTC derivatives suitable for clearing, and significant data on OTC derivatives is reported to trade repositories, the report identifies the following incremental benefits that can result from organised platform trading – namely these are greater pre- and post-trade

transparency; increased market competition; deepened and more resilient pools of liquidity formed around organised platforms; improved market surveillance capabilities; and reduced systemic risk.

The Federal Reserve Bank of New York [published a statement](#) regarding a 27 January meeting on OTC derivatives. Market participants provided supervisors with updates on recent work and agreed to commit to further improvements in support of G20 objectives for reducing risks in global OTC derivatives markets. Participants agreed to communicate next steps and commitments in a collective letter to the OTC Derivatives Supervisors Group by 31 March, in accordance with the recommendations of the FSB in its October 2010 report, *Implementing OTC Derivatives Market Reforms*. The [market participants' letter](#) was duly delivered and has been welcomed.

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Liquidity ratios under Basel III: strategic impact on capital markets and financial institutions – *Personal view by René Karsenti, President, ICMA*



René Karsenti

Stronger regulatory frameworks aim at raising levels of resilience of our banking systems including by constraining the build-up of excessive leverage and maturity mismatches. Under Basel III and the Volcker rule in the US, the objective is to restrict proprietary trading activities as well as to significantly improve the quality of capital and liquidity levels. The legitimate objective is to enable banks to withstand – without extraordinary government support – stresses of a magnitude associated with the recent financial crisis.

The crisis had clearly demonstrated that the old Basel II Tier 1 (and 2) ratio had become of limited relevance. Its definition of capital was too broad, and not sufficiently harmonised. It was biased towards sovereigns' exposures, and incomplete with regard to exposures to off-balance sheet instruments or trading positions.

The combined effect of a minimum leverage ratio, a risk-weighted minimum common equity ratio and capital buffer, and minimum liquidity requirements should result in a better capitalised and thus more resilient banking system. But Basel III requirements are quite demanding and complex. For example, banks will now be assessed on the basis of up to seven different ratios!

Market concern with the Basel measures relates also to their cumulative effect. We should welcome the efforts to secure careful phasing consistent with sustained recovery and limiting market disruption, with the aim of implementation by end-2018.

Liquidity ratios under Basel III: strategic impact on capital markets and financial institutions – *Personal view by René Karsenti, President, ICMA* – continued

Liquidity ratios

A few regulators had established, well before the crisis, liquidity ratios that proved helpful under stress. It has been therefore opportune to address the liquidity problem with a global approach while drawing lessons from past experience.

First, as regards the short term liquidity requirement, I believe that the current definition of eligible “high quality assets” is restrictive on marketable instruments. In particular it eliminates certain highly rated commercial paper, corporate and banking bonds from the list of eligible assets. The risk is that markets for such non-eligible but highly rated corporate and bank assets markets will be distorted and attract higher costs. Current rules will also affect the repo markets by introducing a strict differentiation in the treatment of qualified repos’ underlying assets. It also could lead to unexpected consequences as banks are going to be deterred from keeping on their books long term assets that are indispensable for the financing of the real economy.

Further, the strong emphasis on government bonds is questionable for such liquidity buffers as well as the risk-weighting of sovereigns.

Moreover the Liquidity Coverage Ratio may inevitably result in a race for deposits by the banks, which will try to internalise liquidity that was previously in money market funds. This will probably reduce the development of funding sources. It could also lead to an increase in the remuneration of deposits and therefore increase funding costs of banks.

Regarding the long-term liquidity requirements, present proposals risk to shorten the horizon of bank transformation in a way that would affect the financing of the real economy. This is particularly true in Europe where some 80% of the financing comes from banks, while it is the reverse in the US where the role of financial markets is predominant. Observers such as the EUROFI Institute point out that to comply with the Net Stable Funding Ratio requirements, European banks would have to increase their long term borrowing by some €250 billion a year by 2017. Added to the normal incremental borrowing trend (€160 billion a year to keep in line with nominal growth), the annual amounts to be tapped from the European financial markets would approximately increase by 20% a year, without even taking into account the increasing government funding needs.

Therefore, I believe that supervisors should give some flexibility to determine and fine tune the liquidity requirements. These ratios should not be considered by regulators as minimum ratios but rather as benchmarks. It is therefore welcome that there are to be observation and phase-in periods.

Effects on banks’ business models

I believe also that many new measures will inevitably put pressure on banks’ current business models as well on their profitability, hence reducing the reliance that can be placed on retained earnings to boost capital.

To strengthen their capital, bank financing will increasingly have to come from capital markets. The increase in prudential requirements will probably trigger changes in banks’ activities, in business models and in the amount of focus on different types of customer segments. This is difficult to anticipate at present but that will have an impact on the volume and cost of credit. This could lead banks to focus on the most profitable customer segments. Also, the Basel reforms are expected to have a higher impact in the EU than in the US since banks finance some 80% of Europe’s economy.

Over the medium term, the cost of credit is likely to increase as government and corporate debt refinancing are expanding substantially. Capital market capacity may diminish substantially, as investors would also perceive that bank capital instruments are more risky and that they offer lower returns. At the same time debt finance also faces pressure from resolution-related improvements designed to ensure bondholders are “at risk” of incurring principal losses through bail-ins. Given the complex interaction of all the parts it remains vital to monitor progress vigilantly and remain open to making adjustments to proposals.

These questions should be taken into account as the EU embarks on the transposition of Basel III into legislation while not losing sight of the importance of achieving globally consistent outcomes.

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Transparency and Collective Action Clauses

As reported in the [First Quarter Newsletter](#), on 23 November the ICMA [Sovereign Bond Consultation Paper](#) was sent to members for comment. A summary of feedback has subsequently been circulated to members. In brief this indicated that there is general, though not unanimous, support among respondents for the proposals in the Consultation Paper about greater transparency; and members made a number of practical suggestions about how to achieve this. Respondents were, however, much more cautious about the proposals for improving contractual terms through model Concepts, and about the ICMA's potential role. Responsive to this, ICMA is continuing its efforts to promote full and consistent transparency regarding the terms and conditions applicable to all sovereign bond issues. One element of this is that ICMA believes that all information on issues sold to investors across national borders, which in principle includes all euro-area sovereign issues, should be available in English. Longer term work is also being done to support improvements in market education concerning the implications of key aspects of the contractual terms of sovereign bonds. ICMA's website carries a page dedicated to [Sovereign Debt Information](#), with ongoing efforts being made to improve the quality and presentation of this information.

In September 2002 the Group of Ten (G10) published the [Report of the G10 Working Group on Contractual Clauses](#) which recommended the inclusion of Collective Action Clauses (CACs) in sovereign debt contracts "to promote quicker and more orderly crisis resolution procedures". In April 2003, the EU Member States agreed to include CACs in their sovereign debt issuances "to promote international efforts for orderly restructurings in the event of sovereign debt crises" and [reported on their adoption](#) in November 2004. The recommendation was adopted by a number of European countries in their syndicated, foreign law governed sovereign debt issuances but, on the whole, not in their auctioned,

domestic law governed sovereign debt issuances. ICMA published the current form of the [model CACs](#) for sovereign debt in October 2004 and these model clauses have since formed part of the ICMA Primary Market Handbook.

This particular topic has been the subject of significant focus in ICMA's recent work on sovereign bonds, especially since on 28 November the [Eurogroup announced](#) that, in order to facilitate the negotiation of restructuring plans with private creditors, standardised and identical CACs will be included in the terms and conditions of all new euro area government bonds starting in June 2013. ICMA (with the help of Clifford Chance) has prepared an example of what a euro area CAC might look like, developed in light of the standard CAC in the ICMA Primary Market Handbook. The main changes in this working draft include:

- *aggregation*: the inclusion of an aggregation provision, as proposed in the Eurogroup statement, is intended to allow a sovereign issuer of multiple series of debt securities to facilitate the restructuring of all the debt securities affected;
- *thresholds*: a revision of certain applicable thresholds for voting and quorum would enable sovereigns to obtain more easily a vote in favour of any amendment or restructuring proposal being put to the relevant debt securities' holders, while recognising that a balance needs to be struck between threshold levels acceptable to sovereign issuers and to market participants and investors.

ICMA is actively discussing and considering the best ways in which to continue to refine and improve on this working draft with our members and EU Debt Management Offices, notably through the EFC's Sovereign Debt Markets Group; and is pursuing efforts to elucidate views on best practices relating to the practical aspects of implementing such CAC provisions in the context of euro area sovereign debt issues. This continuing work is now also informed by the [European Council conclusions of 25 March](#). These conclusions reaffirm what had previously been stated by the Eurogroup in November, whilst also elaborating on that earlier statement.

They clarify that the scope is "...securities, with maturity above one year ..."; and provide explicitly for continued "taps". Aggregation will be across issues "... subject to the law of a single jurisdiction ..."; and concepts of non-reserved matters, quorum and disenfranchisement will be addressed. These points of detail are reflective of proposals advanced by ICMA and illustrate the valuable role that ICMA is working to fulfil in this topical debate.

There is also an essential linkage between this work and ICMA's concern to promote full transparency of terms, work to date having underscored that the legal and operational effectiveness of such CAC provisions depends directly on them being clearly disclosed to investors.

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Guidance on buybacks

Since its creation in 2009, the Government, Government Agency and Supranational Bond Markets Working Group of the ICMA AMTE Council has been a forum for discussion and a source of proposals for improving the efficiency of EU government and supranational bond markets, as well as a forum for testing new ideas in an informal way with debt management offices, supranational agencies and dealers.

The Working Group has agreed guidance on increasing the transparency of **buybacks** of public debt and private placements by government and government agency issuers in the EU as well as by supranational issuers, excluding central banks. In setting out their buyback policies, it is recommended that issuers should:

- disclose their overall policy on buying back their own debt (eg whether this is on a case by case basis or they follow predefined patterns or objectives such as the provision of particular liquidity to investors);
- disclose their specific policy on buying back private placements (eg whether they are willing to buy back up to 100% of the issue outstanding);
- disclose their specific policy on buying back public issues;
- disclose, as a result of buybacks, holdings which are material in an appropriate manner that is consistent with relevant regulations for preventing market abuse;
- disclose, through appropriate channels, whether public debt that has been bought back has been redeemed or cancelled; and/or whether it may be held so as to be made available for resale in the market.

When issuers implement the buyback policies they have disclosed by undertaking buybacks, it is recognised that they may choose not to announce the buybacks they have undertaken until after a date set by each issuer to the extent permitted by the relevant regulations for preventing market abuse.

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ECP market

Liquidity regulation: On 16 December, the [Basel Committee on Banking Supervision \(BCBS\)](#) issued the Basel III rules text, which presents the details of global regulatory standards on bank [capital adequacy](#) and [liquidity](#) agreed by the Group of Governors and Heads of Supervision, and endorsed by the G20 Leaders at their November Seoul summit. The rules text presents the details of the Basel III Framework, which covers both microprudential and macroprudential elements. The standards will be phased in gradually so that the banking sector can move to the higher capital and liquidity standards while supporting lending to the economy. Both the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) will be subject to an observation period and will include a review clause to address any unintended consequences.

In particular, the Framework includes details relating to the introduction of two global liquidity standards. This provides some specificity regarding the definition of assets admissible as liquid for purposes of the coverage ratio; and the assumptions to be made in respect of cash inflows and outflows under the liquidity stress scenario that must be covered. More specifically, it is noted that paragraphs 34 et seq. of the [BCBS liquidity rules paper](#) define the “high-quality liquid assets” which may be used to for the required liquidity buffer (including the references to such assets being “traded in large, deep and active repo or cash markets characterised by a low level of concentration”). Subject to a minimum 15% haircut, these may comprise up to 40% “Level 2” assets (paragraphs 41 & 42), which includes certain corporate bonds and covered bonds.

ECP eligibility as ECB collateral: On 4 February the European Central Bank (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*. Previously announced amendments, regarding the risk control measures for assets eligible for use as collateral in Eurosystem credit operations and changes relating to the Short-Term European Paper (STEP) market convention, have now taken effect. This has prompted quite a bit of discussion about the potential listing of bank-issued ECP, in case ECB collateral eligibility is desired. Several euro area exchanges have actively reviewed and updated their applicable listing requirements. Nevertheless, the benefits of collateral eligibility for ECP remain relatively marginal and relatively few issuers have thus far considered the incremental costs of listing to be worthwhile.

CRD's implications for Asset-Backed Commercial Paper (ABCP) structures: Dated 31 December, the Committee of European Banking Supervisors (CEBS) has [published its final guidelines](#) on the application of Article 122a of the Capital Requirements Directives (CRD). Article 122a of the CRD provides new requirements to be fulfilled by credit institutions when acting in a particular capacity, such as originator or sponsor, and also when investing in securitisations. These include retention on an on-going basis of a material net economic interest of not less than 5% (so called “skin in the game”), due diligence and disclosure. CEBS expected its members to adopt the guidelines into their national supervisory framework and apply them from 1 January 2011, ie when the new Directive provisions came into force. Both the guidelines and the feedback statement include a number of specific references to “ABCP”, which henceforth need to be carefully considered in the context of Asset-Backed Commercial Paper structures.

MiFID: On 8 December, the European Commission [launched a consultation](#) on the review of the Markets in Financial Instruments Directive (MiFID). The purpose of this consultation was to gather input from all stakeholders in order to inform legislative proposals due in summer 2011. The response deadline was 2 February and [ICMA submitted a response](#).

Two particular matters have been considered by ICMA with specific relevance for the ECP Committee, the first being related to ABCP. In its section 3.4. the [MiFID CP](#) says that the non-equity transparency “...requirement would apply to: a) all bonds and structured products with a prospectus or which are admitted to trading either on a regulated market or MTF; and ...”. As ABCP will no doubt be considered a “structured product”, ICMA has recommended that the Commission should clarify its proposal in a way that aligns it with the earlier advice from CESR that it “does not currently see a need for a post-trade transparency regime for ABCPs.”

The second relates to a proposal to create a new type of regulated venue called an “organised trading facility” (OTF), which would complement the existing MiFID concepts of regulated markets (RMs), multilateral trading facilities (MTFs) and systematic internalisers (SIs). The proposal is that OTFs would be “...any facility or system operated by an investment firm or a market operator that on an organised basis brings together buying and selling interests or orders relating to financial instruments.” The existing [MiFID Framework Directive](#) defines “Financial Instruments”, in Section C of Annex 1, as: transferable securities; money market instruments (broadly being short-term funding); UCITs; and derivatives. Thus, as proposed, OTFs will apply to money market instruments, which extension to the scope of MiFID ICMA believes is excessive. At the least, any regime

for money market instruments ought to be specifically tailored as against those which may apply for transferable securities or derivatives.

Money market funds: Under cover of a [21 October press release](#), the US President's Working Group (PWG) on Financial Markets released its long-awaited study of possible further US money market funds' reforms. Dated 3 November, the US Securities and Exchange Commission (SEC) has [published a request for comment](#) on the options discussed in the PWG's report. Albeit that this consultation formally closed on 10 January, this continues to attract [submitted comments](#).

Alongside a press release dated 10 March, Moody's has published its new global methodology for rating money market funds. This revised money market fund rating methodology incorporates market feedback that Moody's received after publishing its request for comment on the same subject in September 2010. The analytical framework uses a set of objective measures to assess portfolio credit quality as well as market and liquidity risks in stress scenarios in order to differentiate among funds. In addition, Moody's is introducing a new set of rating symbols and definitions. A money market fund's risk will be expressed through rating symbols similar to Moody's current rating symbols and market convention, but will append a "money market fund" or "mf" modifier to highlight the distinct meaning of Moody's money market fund ratings. This new rating methodology is scheduled to become effective on 20 May.

Meanwhile, as part of its reform programme, the [SEC has proposed](#) rule amendments to remove credit rating references in Investment Company Act rules and forms, including Rule 2a-7 governing the operations of money market funds. The focus of these efforts is to eliminate over-reliance on credit ratings by both regulators and investors, and encourage an independent assessment of creditworthiness.

Repo market

ICMA European Repo Council (ERC) White Paper: The [ERC White Paper](#) on the working of the repo market was published on 13 July last year, with an [update](#) published on 17 December. A [further update](#), regarding developments in Italy and Greece, was recently published on 25 March.

Liquidity and capital: On 16 December, the Basel Committee on Banking Supervision (BCBS) [issued](#) the Basel III rules text, which presents the details of global regulatory standards on bank [capital adequacy](#) and [liquidity](#) agreed by the Governors and Heads of Supervision, and endorsed by the G20 Leaders

at their November Seoul summit. The rules text presents the details of the Basel III Framework, which sets out higher and better-quality capital, better risk coverage, the introduction of a leverage ratio as a backstop to the risk-based requirement, measures to promote the build-up of capital that can be drawn down in periods of stress, and the introduction of two global liquidity standards.

Two elements of these latest BCBS capital and liquidity papers are noted as being of particular relevance to the ERC:

- *Leverage:* paragraph 159 of the [BCBS capital rules paper](#) clarifies the netting for Securities Financing Transactions (SFT) when calculating leverage ratio exposures, stating: "SFT are a form of secured funding and therefore an important source of balance sheet leverage that should be included in the leverage ratio. Therefore, banks should calculate SFT for the purposes of the leverage ratio by applying: the accounting measure of exposure; and the regulatory netting rules based on the [Basel II Framework](#)." (Excepting the rules for cross-product netting in [Annex 4](#), section 3).
- *Liquid assets:* paragraphs 34 et seq. of the [BCBS liquidity rules paper](#) define the "high-quality liquid assets" which may be used for the required liquidity buffer (including the references to such assets being "traded in large, deep and active repo or cash markets characterised by a low level of concentration"). Subject to a minimum 15% haircut, these may comprise up to 40% "Level 2" assets (paragraphs 41 & 42), which includes certain corporate bonds and covered bonds.

It is also noted that paragraphs 84-87 of this latter paper govern "secured funding run-off", whilst paragraphs 108-110 govern the inflows treatment for "reverse repos and securities borrowing".

CCP exposures: As reported in the [First Quarter Newsletter](#), on 20 December, the BCBS [issued a consultative paper](#) on the capitalisation of bank exposures to central counterparties. Generally speaking, the BCBS proposed that trade exposures to a qualifying CCP will receive a 2% risk weight. Consultation responses were requested by 4 February 2011.

On 9 February, the European Commission [launched a public consultation](#) seeking stakeholders' views (by 9 March) on proposed measures to strengthen bank capital requirements for counterparty credit exposures arising from derivatives, repo and securities financing activities. The measures are based on the above-mentioned work of the BCBS and will form part of the Commission's upcoming legislative proposal to implement Basel III reforms into EU law. The purpose of this latest consultation is to gather stakeholders' views on two specific issues in the area of counterparty credit

risk, namely: capitalisation of bank exposures to central counterparties (CCPs), with a proposed 2% risk weight; and treatment of incurred credit valuation adjustments (CVA).

Crisis resolution: On 6 January, the European Commission [launched a consultation](#) on technical details underpinning its proposed crisis resolution framework. This follows from the Commission's 20 October [Communication on Crisis Resolution](#), which included a statement that: "... the Commission considers that the framework should include provision for a temporary stay on rights to close out netting where authorities transfer relevant contracts as part of a resolution measure, and will consult with experts on the details of such a provision. Further consideration may also need to be given to the exercise of close out rights in connection with early intervention measures." January's consultation includes further elaboration of these points in a section on "Temporary suspension of rights", especially that part headed "Temporary suspension of close out netting (G13)"; and a section on "Safeguards", especially that part headed "Appropriate protection for financial collateral, set-off and netting arrangements (H2)."

Comments were requested by 3 March and the ERC has [submitted a response](#) concerning these repo-oriented aspects. Having commented on several points of technical detail, the ERC concludes by noting that the arrangements under consideration in these consultation proposals need to be carefully developed to take account of repo (and other types of financing) trades, in addition to underlying cash securities trades. The ERC considers that, whilst it is right to seek the orderly resolution of a failing institution, this must be balanced with the market need for prompt close out so as to mitigate the risk of adverse market movement during the period of suspension. The imposition of rigid or ill defined constraints could serve to impede established market practice for the efficient (repo) financing of securities positions.

Netting: Concern regarding deficiencies in the European legal framework regarding netting and set-off is now under increased focus in light of the interaction this has with the European Commission's work on crisis resolution. The Commission has determined that this should be fixed through a new EU legal instrument, rather than by amending an existing legislative instrument, and hence anticipates a draft Netting Directive in 2011. The Commission is actively advancing this initiative, including through market dialogue.

On a related note, on 28 January the International Accounting Standards Board (IASB) and the US-based Financial Accounting Standards Board (FASB) [published a proposal](#) to establish a common approach to offsetting financial assets and financial liabilities on the statement of financial position (balance sheet). The boards are proposing that offsetting should apply only

when the right of set-off is enforceable at all times, including in default and bankruptcy, and the ability to exercise this right is unconditional, that is, it does not depend on a future event (for instance, a default). The entities involved must intend to settle the amounts due with a single payment or simultaneously. Provided all of these requirements are met, offsetting would be required. [In summary](#), the proposed requirements are broadly comparable to the requirements contained in IAS 32 currently (in other words the proposal largely acts to move US GAAP to where IAS already is); but clarify that the right of set-off should be enforceable both currently and upon default. To ensure clarity about the assets and liabilities subject to set-off and the related arrangements, enhanced disclosures are proposed. Any comments are due by 28 April.

Legal certainty: On 5 November 2010, [consultative proposals](#) in respect of the harmonisation of the legal framework for securities holding and transactions were announced by the European Commission. The objective of this consultation was to inform the preparation of a formal Commission legislative proposal scheduled for adoption before summer 2011. Comments were requested by 21 January and the ERC, drawing on work of the ERC Operations Group, [submitted a response](#) concerning repo-oriented aspects of this consultation. This response comments on concern regarding some practical implications of points in this proposal which are not yet sufficiently clearly detailed; draws attention to the need to take due account of differences relating to the repo market; and calls for care to avoid adverse impacts on sound, established repo market practices. The Commission has subsequently published a [summary of responses](#) and made public copies of the responses themselves.

CSD Regulation: On 13 January, the European Commission [launched a consultation](#) on Central Securities Depositories (CSDs) and on the harmonisation of certain aspects of securities settlement in the European Union. The purpose of this [consultation paper](#) is to gather input to inform legislative proposals due in June. In order to increase the safety and efficiency of the internal market for securities transactions, the European Commission intends to introduce harmonisation of key aspects of securities settlement. The key elements of the consultation are:

- *common regulatory framework for CSDs:* CSDs in the EU should operate under a common regulatory framework that ensures the robustness of their operation. Such a framework should include common definitions of CSD services, common rules on authorisation on ongoing supervision of CSDs, high prudential standards for CSDs and rules on access and interoperability. The consultation seeks stakeholders' comments on the proper design of such a common regulatory structure; and

- *harmonisation of key aspects of securities settlement*: the consultation also asks what measures could be taken to address concerns relating to the well-functioning of securities settlement. It seeks stakeholders' input on how to improve settlement discipline, ie that a transaction actually settles on the intended settlement date. This question is linked to the [proposal for a Short Selling Regulation](#) which already foresees specific measures arising from patterns that factor in late settlement into a trading strategy. Another important aspect of the consultation concerns the harmonisation of settlement periods, ie the time between the conclusion of a transaction and settlement. Currently, European securities markets do not follow a common settlement period (eg for equities, regulated markets either settle two days or three days after trade (T+2 or T+3)).

This initiative is an important part of the Commission's agenda to enhance the safety and soundness of the financial system. Together with the [proposal for a Regulation on OTC Derivatives, Central Counterparties and Trade Repositories \(EMIR\)](#) adopted by the Commission on 15 September 2010 and MiFID ([currently under review](#)), it will form a framework in which systemically important securities infrastructures (trading venues, central counterparties, trade repositories and central securities depositories) are subject to common rules on a European level.

The deadline for replies to January's CSD consultation was 1 March and the ERC has [submitted a response](#) concerning repo-oriented aspects. This response draws attention to the ERC's White Paper on the repo market and highlights the need to carefully consider differences between markets in formulating proposals – it cannot be assumed that what is considered appropriate for equity markets is equally applicable for other markets. Linkages are drawn to the ERC's work on market efficiency, to related work that has been undertaken in the context of discussing the Commission's proposed Short Selling Regulation and to the associated efforts of the HSC Working Group (see below).

There are also a number of points made concerning questions of access and interoperability, including an important emphasis on the need to maintain an environment in which both settlements in central bank money and in commercial bank money coexist in appropriately controlled ways. In this regard, attention is drawn to an important [2003 CPSS report, *The Role of Central Bank Money in Payment Systems*](#). The Commission has subsequently published a [summary of responses](#) and made public copies of the responses themselves.

Harmonisation of settlement cycles: Following on from work over several years relating to Giovannini barriers, the Harmonisation of Settlement Cycles (HSC) Working Group was established by CESAME 2. The HSC Working Group [submitted its final report](#) as a reply to the European Commission's consultation on CSDs and on the harmonisation of certain aspects of securities settlement. This response describes the origins of the HSC Working Group; provides an overview of its work; responds to certain specific questions from the Commission's consultation; and offers perspectives on further work once there is clarity on the applicable future legislative proposals. Amongst annexes to this HSC Working Group submission are a report on *Principles for the Maximisation of Settlement Efficiency* and a paper on *The Case for Harmonising Settlement Cycles*.

MiFID: [ICMA submitted a response](#) to the European Commission's consultation on the MiFID Review. Amongst the many aspects of this (see other sections of this Newsletter), two highlighted by the ERC are:

- the transparency proposals in relation to the market for cash fixed income securities, which have the potential to significantly impact trading behaviour; and
- the proposals to form a new type of regulated market, termed an "organised trading facility", which potentially cover the trading of money market instruments.

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The GMRA 2011

Looking back

The Global Master Repurchase Agreement (GMRA) is the foremost agreement for documenting cross-border repo transactions. ICMA has fostered the development of the agreement for some 20 years, encouraging what was once a mainly undocumented market to improve and standardise market practice by adopting the legal framework of the GMRA.

The GMRA was first introduced to the market in 1992 and since then two further versions have been published, the [GMRA 1995](#) and the [GMRA 2000](#). Just over a year ago ICMA's European Repo Committee put together a Working Group to consider whether it was necessary to update the 2000 version of the GMRA.

The Working Group was made up of market practitioners and legal and documentation specialists. The group also worked closely with SIFMA's MRA Review Working Group and kept the European Financial Market Lawyers Group informed of its discussions. The Working Group was assisted by Michael Raffan from Freshfields Bruckhaus Deringer and Habib Motani from Clifford Chance.

In its coordination of the review process, ICMA has proactively reached out to the market in order to ensure that the result is a revised agreement which satisfies the requirements of its users and can withstand increasingly challenging market conditions.

The Working Group has considered a vast range of issues as part of its review of the GMRA, including but not limited to:

- the default process in the post Lehman environment;
- calls for harmonisation across master agreements;
- changing insolvency/ bankruptcy regimes; and
- changing repo market practices.

Key amendments and enhancements

- *When is an Event of Default deemed to have occurred?* Under the GMRA 1995 and 2000, except in the case of certain acts of insolvency where default is automatic, the non-defaulting party has the discretion to decide whether these events are to be treated as events of default giving rise to termination of the agreement. In order for an event to be deemed an Event of Default, the non-defaulting party must serve a Default notice. It has the option to do so, but is not compelled to do so. The GMRA 2011 alters this methodology and brings the agreement in line with the equivalent practice of the ISDA master agreement. That is to say that the occurrence of an event of default now results from the fact pattern, not from the serving of a default notice. The non-defaulting party now triggers termination of the agreement by designating an early termination date, which, as with the former default notice, it has the option to do, but is not compelled to. The importance of this amendment is two-fold. First, the harmonisation of the process for calling for early termination

of an agreement with the ISDA master agreement creates efficiencies for users and should reduce confusion when closing out agreements across product types in times of market turmoil. Secondly, where parties have cross default clauses in their agreements with the defaulting party, there is increased clarity as to whether or not an Event of Default has occurred under the GMRA.

- *Events of default – expansion of the Acts of Insolvency definition:* The definition of “Act of Insolvency” in the GMRA includes those events considered to be clear indications of a counterparty's inability to perform its obligations under an agreement of this type. These form part of the list of Events of Default which may trigger early termination of the agreement. In the GMRA 2011, a new event has been added to the list of Act of Insolvency events and the definition of other types of Act of Insolvency events have been amended, in order to ensure that the drafting adequately covers all relevant indications of insolvency. The new Act of Insolvency event relates to “the carrying out of enforcement measures in relation to all, or substantially all assets of a party”. It is an act of insolvency event currently found within the ISDA master agreement and therefore further harmonises the GMRA with the latter. As with the previous change, the benefit of this amendment is increased clarity in terms of the definition of Act of Insolvency, as well as efficiencies in relation to taking a coordinated approach upon the occurrence of an insolvency-related event across master agreements.
- *Default valuation time:* On default, the GMRA 2000 allows the non-defaulting party to calculate the close out amount by reference to actual sale or purchase prices or, if they so choose, the market value of the securities, in either case, at any time during the 5 dealing days following the occurrence of the event of default. The GMRA 2011 affords more flexibility as to the timing of such calculation, providing that the default market value of any equivalent securities or equivalent margin securities shall be determined by the non-defaulting party *on or as soon as reasonably practicable after the early termination date*. In times of market turmoil, the extra flexibility this approach affords will be invaluable to the orderly liquidation and/or valuation of positions.
- *Something old, something new: margin percentage:* The concept of margin percentage is introduced to the GMRA 2011 to formalise the possibility for applying a haircut to margin securities. Such rate is agreed by the parties bilaterally, acting in a commercially reasonable

manner and is applied when calculating the Market Value of Margin Securities for the purposes of margining. This change updates the agreement in respect of current market practice.

- *Dual purpose spot rate:* The GMRA 2000 defines the Spot Rate (foreign exchange conversion rate) as the relevant rate quoted by Barclays Bank PLC, unless otherwise agreed by the parties. The GMRA 2011 amends this definition and splits it into two. For the purposes of paragraph 10 (default valuation) the spot rate is obtained by reference to a pricing source or quoted by a bank, in each case, specified by the non-defaulting party at such dates and times determined by the non-defaulting party. This provides the non-defaulting party with the appropriate flexibility to indicate the conversion rate used in a default scenario. For any other purpose, the spot rate is obtained by reference to a pricing source or quoted by a bank, in each case agreed by the parties, or absent such agreement, by the buyer.
- *Margin maintenance and the cash equivalent amount:* Under the GMRA 2000, where a party that has called for margin has previously delivered margin securities, it is entitled to have these returned. It can be deemed an event of default to fail to deliver such equivalent margin securities. The GMRA 2011 recognises that a party, having made all reasonable efforts to do so, may, for reasons relating to the Securities or the clearing system through which the Securities are to be transferred, be unable to deliver equivalent margin securities. The revised agreement provides a mechanism whereby a cash amount equal to the Market Value of the margin securities may be transferred as a substitute. If, after a period of two days, the failure is continuing, the receiving party may, by notice, require the transferor to pay a cash equivalent amount equal to the default market value of the equivalent margin securities. This amendment carefully balances the rights of the party calling for return of the securities with those of the party obliged to deliver the securities. There is no interest payable on the initial cash amount transferred so as to avoid unjust enrichment and it is the default market value of the securities which is used as basis for calculating the cash equivalent amount payable after the two day grace period.
- *Set-off:* The GMRA 2011 introduces a set-off clause to the agreement. This allows the non-defaulting party to reduce any amount payable after closing out the agreement, by any amount owed under any other agreement between the parties. Once again this represents a point of harmonisation with the ISDA master agreement and an increased capacity to mitigate exposure under the agreement.

Schedule and support

The agreement will be published in April, alongside the 2011 ICMA GMRA legal opinions. ICMA continues to be the sole provider of industry standard opinions on the GMRA and as mentioned, this year's opinions will not only cover the GMRA 1995 and 2000 but will also opine on the GMRA 2011.

The GMRA 2011 is the result of a market-driven process and ICMA will support initiatives to implement the revised documentation. Please let us know how we might assist, in addition to our current educational and training offerings and the support of the [Legal Helpdesk](#).

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2011 ICMA GMRA legal opinions update

The [2011 ICMA GMRA legal opinions update](#) will shortly conclude with updates of the 2010 legal opinions being obtained in over 60 jurisdictions. Of particular significance this year is the addition of an opinion for Russia. Recent amendments to Russian legislation have improved the environment for repo and derivatives trading in this jurisdiction. ICMA has commissioned Freshfields, Moscow to produce an opinion on the GMRA, which will be made available on the [ICMA website](#) shortly.

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Prospectus Directive review and PRIPs

On 25 February, as the latest step in the on-going review of the EU Prospectus Directive (PD) regime, ICMA submitted a [response](#) to ESMA's [call for evidence](#) on the European Commission's [request for technical advice](#) on possible delegated acts concerning the PD. The response focused on the form of, and interaction between, summaries, final terms and supplements, as well as on the consent to third party prospectus use and on specific suggestions for amendments to the PD Regulation. Regarding final terms in particular, ICMA is aware there has been regulatory concern regarding the type of information that has been included in some final terms over the past few years. Imposing both a strictly prescribed and limited form of final terms could however substantially hamper the flexible and speedy issuance of securities that underpins the base prospectus concept. ICMA has pointed instead to the base prospectus summary as the point of reference for the PD's "significant new factor" test in terms of establishing whether additional information should be included in a supplement to the base prospectus rather than in final terms. ICMA has been engaging in a round of bilateral meetings with national regulators on all these aspects.

ICMA is also considering any consequent changes to standard market practice and documentation flowing from the publication of the December 2010 amendments to the PD (discussed in the [First Quarter edition](#) of this Newsletter). In particular, ICMA will shortly be publishing revised standard form debt selling restrictions. A revision of the equity selling restrictions is being considered and may follow in due course.

Furthermore, on 1 February ICMA, via the Joint Associations Committee on retail structured products, submitted a detailed [response](#) to the European Commission's [Packaged Retail Investment Products \(PRIPs\) consultation](#), notably concerning the proposed key information document (KID) previously discussed in the [July 2009 edition](#) of this Newsletter. ICMA has in particular been concerned that, in formulation of the PRIPs KID, proper account is given to its intended purpose. If it is anticipated that such a document be strictly limited to two pages (the maximum length the European Commission's [UCITS Disclosure Testing Research](#) seems to indicate that retail investors will read), then it cannot include all information necessary for an informed assessment (which is specified under the PD as the role of the full prospectus). Rather a KID should be a quick first point of comparison for investors before seeking more detailed information (in the case of the more sophisticated investors) or as a good introduction to the

PRIP and a means of arming themselves with questions to ask a financial advisor (for the least sophisticated investors) – as noted in the Commission's research. Any liability deriving from information in the KID should accordingly be qualified by reference to the full prospectus. Distinctly, it is fairly likely that the information presented in a KID might be customised to specific and differing types of investor and would include such things as distributor charges and investor specific tax aspects – all knowable only at distributor level (and this dynamic would be similarly applicable should a KID ever need to include updated information on a distributor's later re-offering of the PRIP). Consequently, responsibility for preparing KIDs should be left open for issuers and distributors to agree as necessary.

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ISMAG: issuer and agent letters of representation

Previous editions of this Newsletter ([January and April 2008](#), and [January and July 2009](#)) have reported on the "ISMAG" process – the International Securities Market Advisory Group established and led by the two International Central Securities Depositories (ICSDs), Euroclear Bank and Clearstream Banking. ICMA is an observer at meetings of the group, rather than an actual member of the group itself.

The reports covered the ICSDs' related Market Practice Book (MPB) first published in 2008 with 48 pages and then subsequently revised, with the 176 page February 2011 version being available as of 31 March on both the [Clearstream ISMAG webpage](#) and the [Euroclear ISMAG webpage](#). The MPB is stated to describe what the ICSDs consider to be "best practices" for operational processes in new issues, corporate actions and income payments for international securities primarily issued through, and deposited with, the ICSDs. ICMA has advised the ICSDs that some other market constituencies may have differing views as to what constitutes good, let alone best, practice in these areas. In particular, issuers may feel that all information they have carefully prepared for delivery to their investors should simply be delivered to the end-investors in its original form (and not subject to being summarised, truncated or otherwise interpreted along the way). Specifically concerning the extent of lead-manager responsibilities (including their advisers), ICMA issued [Guidance Note 8](#) in the [IPMA Handbook](#) (being rebranded the ICMA Primary Market Handbook).

The ICSDs are now asking issuers (and their agents) to enter voluntarily (at least for the time being) into letters of representation with the ICSDs concerning such issuers' (and agents') compliance with the MPB as amended from time to time by the ICSDs (the ICSDs will also compile key performance indicators to monitor such compliance). Further information can be found on the relevant "market framework" webpages of [Euroclear](#) and [Clearstream](#). It is likely that issuers will wish to obtain detailed advice from their legal counsel and their agents in order to get a clear understanding as to what obligations and potential liabilities they would be undertaking if they were to enter into such letters of representation. In this respect, it is worth recalling that even non-contractual obligations may have some implications for liability in tort and there are potential reputational implications resulting from any public identification of issuers as being non-compliant.

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Other primary market developments

Several other developments are worth noting:

- *Bookbuilding and allocations* – MiFID response: As anticipated in the [First Quarter edition](#) of this Newsletter, on 2 February ICMA submitted its [response](#) to the European Commission's [MiFID consultation](#). The response included two sections on "underwriting" (questions 86 and 124) that expanded on the main points discussed in the [First Quarter edition](#) of this Newsletter (and noted in IPMA Handbook Explanatory Note XIII that was also discussed in that edition of this Newsletter).
- *Legal certainty of securities holding and dispositions*: ICMA has submitted a [response](#) to the Commission [consultation on Legal Certainty of Securities Holding and Dispositions](#), emphasising, from the primary markets perspective: (i) the importance of the good discharge to issuers for sums paid to depositories for the two International Central Securities Depositories (ICSDs), Euroclear and Clearstream; (ii) the validity of notices to holders delivered by issuers to the ICSDs; and (iii) the natural impact of differing holding chain lengths on the concept of equal treatment.
- *Financial regulation in the UK*: Following its previously reported October [response](#) and December [follow-up letter](#) to the UK Treasury's [consultation Cm 7874, A New Approach to Financial Regulation: Judgement, Focus and Stability](#), ICMA is now intending to submit a response to the UK Treasury's [follow-up consultation Cm 8012, A New Approach to Financial Regulation: Building a Stronger System](#) by the stated 14 April deadline.
- *European Pre-Issuance Messaging (EPIM) system for ISIN allocation*: ICMA continues to liaise with the ICSDs as to the [proposed mandatory extension](#) of the EPIM system for ISIN allocation to MTN issuance, further to the [announcement](#) of the postponing of the implementation deadline from 1 February to 1 July and to the serious challenges faced by banks in establishing relevant systems in time.
- *Third country equivalence under the Statutory Audit Directive*: The European Commission has adopted a [Decision](#) on third country equivalence under the Statutory Audit Directive (SAD), following its [prior transitional Decision](#) that only applied to financial years starting during the period from 29 June 2008 to 1 July 2010. This is relevant, *inter alia*, in terms of which third country auditors are able to audit financials for prospectuses to be approved under the EU's Prospectus Directive (distinctly from what accounting standards may be used). Ten countries (Australia, Canada, China, Croatia, Japan, Singapore, South Africa, South Korea, Switzerland and the United States of America) are now considered to be equivalent under the SAD, whilst a further 20 countries (Abu Dhabi, Bermuda, Brazil, Cayman Islands, The Dubai International Financial Centre, Egypt, Guernsey, Hong Kong, India, Indonesia, Isle of Man, Israel, Jersey, Malaysia, Mauritius, New Zealand, Russia, Taiwan, Thailand, Turkey) benefit from a further transitional period applicable to financial years starting during the period from 2 July 2010 to 31 July 2012. Interestingly, the transitional regime involves a non-application of the SAD's Article 45 registration and related supervision requirements (subject just to alternative provision of basic information), whilst formal equivalence seems to involve submission to the SAD's registration requirements with just an option discretion for individual EU Member States to exempt registered equivalent third country auditors from such Member States' quality assurance systems.

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MiFID review

The European Commission continues to consider the many submissions received in response to the consultation which ended on 2 February. [In its submission, ICMA:](#)

- encourages the Commission to consider the full implications of its proposals;
- proposes to expand the definition of “admission to trading”;
- recommends that the Commission excludes money market instruments from MiFID;
- asks the Commission to accommodate bilateral trading and hybrid systems within the “organised trading facility” (OTF) category;
- calls for the scope of the non-equity pre-trade transparency framework to be limited to large investment grade bond issues;
- supports CESR’s recommendation not to introduce mandatory pre-trade transparency outside the equity market;
- advocates that the post-trade transparency framework be based on high/low/median prices published at the end of day, with appropriate delays to accommodate the unique nature of the bond market and phased implementation of the new requirements;
- agrees that title transfer collateral for retail clients should be properly managed, but not prohibited;
- offers to assist in the development of any further proposals in respect of the underwriting and placing process in the primary market.

For the cross-border fixed income markets, it is clear that there will be substantial changes to current market practice; it seems likely that there will be widespread, mandatory post-trade transparency perhaps including a “consolidated tape” of prices at which bonds have been traded.

The extent to which pre-trade transparency will be mandated at European level is less clear, as many voices (including ICMA) continue to call on the Commission to implement CESR’s technical advice from July and October 2010 rather than to go beyond it.

On 10 March, ICMA and a number of other associations [wrote to Commissioner Barnier](#), expressing support for the principle of broadening investors’ choice. The signatories believe that preserving investors’ freedom to choose where to execute trades is entirely compatible with the goals of ensuring transparency, strong risk management and operational efficiency.

We continue to press our points in contacts with policymakers and others. The Commission’s proposals are still expected before the summer break, at which time a further round of work to identify the issues will be initiated. As usual, we will seek to coordinate with other trade associations where we can.

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Short selling

Since the publication of ICMA's First Quarter Newsletter, the Commission's proposed Regulation on Short Selling, published on 15 September 2010 has been the subject of intense scrutiny and discussion.

The Hungarian EU Presidency published a [revised compromise text](#) for the proposed Regulation on 4 March 2011. A [further compromise text](#) was subsequently issued on 25 March. The following amendments are of note:

- A new Recital (15a) has been included to the effect that the definition of a short sale is not intended to include a repurchase agreement (repo) or a transfer of securities under a securities lending agreement. This is carried forward in the definition of short sale in Article 2(1)(p).
 - Recital 16 has been amended so that the fact that a short sale will be covered by a purchase of the instrument during the same day can be considered as an example of offering a reasonable expectation that settlement can be effected when due.
 - The definition of a short or long position (Article 3) is now drafted in respect of issued share capital of a company or issued sovereign debt of a sovereign debt issuer. Corporate debt is not included within the scope of this compromise text. The calculation of a short or long position includes: (a) any sovereign credit default swap (CDS) that relates to the sovereign issuer; (b) any instrument giving rise to an exposure, whether direct or indirect; or (c), any economic interest held as part of a basket, index or exchange traded fund.
 - Notifications to competent authorities and public disclosures are limited to (a) net short positions in shares, (b) net short positions relating to the issued sovereign debt of a sovereign issuer or (c) an uncovered position in a sovereign CDS. In respect of (b) and (c), ESMA will specify the relevant thresholds. The notification or disclosure must be made not later than 15:30 on the next trading day.
 - Article 12 sets out the restrictions on uncovered short sales. Short sales may only be entered into in respect of shares admitted to trading on a trading venue or sovereign debt if:
 - the person has borrowed the share or sovereign debt or has made alternative provisions resulting in a similar legal effect;
 - the person has entered into an agreement to borrow the share or sovereign debt or has another absolutely enforceable claim under contract or property law to be transferred ownership of a corresponding number of securities of the same class so that settlement can be effected when it is due;
 - the person has an arrangement with a third party under which the third party has confirmed that the share or sovereign debt has been located or has otherwise reasonable expectation that settlement can be effected when it is due.
- This restriction does not apply to a short sale of sovereign debt if the transaction serves to hedge a long position in debt instruments of an issuer, the pricing of which has a high correlation with the pricing of the given sovereign debt.
- Article 13 is limited to buy-in procedures applying to central counterparties that provide clearing services for shares. Such CCPs must ensure that procedures are in place so that, where a person is unable to deliver shares for settlement within four business days after the day settlement is due, then procedures are automatically triggered for the buy-in of the shares. Where the buy-in of the shares is not possible, then an amount is to be paid to the buyer based on the value of the shares plus an amount for losses incurred by the buyer as a result of the settlement failure.
- However, the position of the Council has to be contrasted with the position taken by the European Parliament. On 7 March, the Parliament's Economic Affairs Committee (ECON) voted:
- to ban certain trades in sovereign bonds. In particular, the ECON position would prohibit anyone from being involved in CDS transactions if they do not already own sovereign debt linked to the CDS ("naked CDS trading") or securities whose price depends heavily on the performance of the country such as shares in a major company based there;
 - to require traders to settle their uncovered positions by the end of each trading day – ie they must convert their naked short sale into a short sale by the end of the trading day. Accordingly, "naked" short selling is not banned entirely. However, a seller failing to make the conversion before the deadline would incur a fine which would be sufficiently high as to prohibit any profits being made;

- to preserve the Commission's "locate and reserve rule" whereby the seller must not only identify from where it plans to borrow the shares in question but must also have a guarantee that it will indeed be able to borrow them when the time comes;
- to require firms to report on their short sale transactions at the end of the trading day rather than reporting each short sale as it happens, as originally proposed by the Commission.

A copy of the ECON press release can be found [here](#). However, it is worth noting that some MEPs consider that some of the compromise texts are still not satisfactory, especially those texts that address uncovered short sales and CDS.

In addition, it is not just the European Parliament and Council that are taking very distinct positions on the proposed Regulation. This can be seen looking at the views of the European Economic and Social Committee (EESC), the European Central Bank (ECB) and the UK's House of Lords European Union Sub-Committee on Economic and Financial Affairs.

- The [EESC's report](#) was published on 20 January, after being adopted by 200 votes to four with seven abstentions.
- The [European Central Bank's opinion](#) of the proposed Regulation was published early in March.
- The House of Lords European Union Sub-Committee on Economic and Financial Affairs has published a [letter to Mark Hoban MP](#), Financial Secretary to the UK Treasury.

Given the diversity of opinions surrounding the proposed Regulation it is still unclear what the final version of this Regulation will look like. The next steps are for a Parliamentary plenary sitting on 9 May, while in the Council political agreement on the final Act is expected on 17 May.

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IOSCO suitability standards for complex products

The International Organization of Securities Commissions (IOSCO) has begun work on preparing global standards for the regulation of suitability in relation to complex financial products. IOSCO will consult on draft standards, possibly in late 2011 or early 2012, taking account of current developments in suitability regulation in the EU and US.

As yet, IOSCO's work is at an early stage, and details of the possible content of the standards were not yet available at the time of writing. We understand that IOSCO does not intend to extend the work beyond "complex products", but that it does propose to cover both advised and non-advised services, and both retail and non-retail clients.

ICMA's work on IOSCO's initiative will be done collectively through our membership of the International Council of Securities Associations (ICSA), through whom it is likely that we will engage with IOSCO's consultation, rather than doing so directly.

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The future of the fixed income trading business

The fixed income trading business has to cope with an unusual matrix of pressures over the next few years. These include continued high levels of issuance by banks and governments – but not only these – which will require secondary market support in some shape or form; the continuation of macroeconomic imbalances, between the “Old World” – ageing, de-industrialising, with a substantial debt overhang and low growth prospects – and the “New World” – young, industrialising, with low levels of debt and attractive prospects for economic growth; and the consequences of the financial crisis, which include avid production of detailed, prescriptive conduct of business regulation aimed at the financial sector as well as work on financial regulation (liquidity and capital adequacy in particular) and market structure (shift of business to organised, transparent trading venues; mandatory central clearing for some products) and the broadening and deepening of regulators’ powers, such as the power to ban certain products. The reform agenda is proceeding at pace and at a globally coordinated level. OTC markets in a wide range of products, including bonds, equities and derivatives are at the forefront.

At the same time, as the acute phase of the financial crisis recedes, market participants are focusing on future threats and opportunities, both for their own business and for the particular financial markets in which they operate.

It seemed, therefore, that now would be a good time to produce some research to assist members to think about how to navigate these hazards. We are therefore planning to produce a paper on the future of the fixed income trading business, drawing on our own experience and the insights of members.

The target audience for the paper is business managers in member firms. The main questions to be addressed include:

- Where should firms invest their capital?
- What account needs to be taken of new technological developments, such as automated trading and electronic platforms (eg as a result of Cassiopeia)?
- What is likely to be the impact on the business of changes in the secondary market infrastructure (taking account of MiFID and EMIR)?

As well as drawing lessons from the past, the paper will compare and contrast government bond markets (rates) with developments in the market for corporate bonds – including the bonds issued by banks (credit).

Other issues to be discussed could include:

- Will there be a return to traditional merchant/investment banking? If so, the consequences might include:
 - relationship management returning to pre-eminence – the long view coming to dominate the short view;
 - trading returning to a support role and ceasing to be a prime driver of profit; and
 - long term business growth (and stability) ceasing to be dependent on short term trading priorities.
- If the last 10 years have been an aberration not a paradigm change, what will the next 10 years look like?
- Since it seems that a successful primary market is no longer dependent on the secondary market to place bonds in firm hands, would it matter if the secondary market remains relatively small or even returns to pre-1992 levels? Alternatively, some major corporate customers might demand that the price for lead management is maintaining a secondary market in their bonds, as governments seek to do?
- Could spreads in corporate bonds ever get so narrow that continuous secondary market trading is viable as it is in some government markets? If so how would that happen?

We are planning to produce the paper in the third quarter of this year, under the governance of the Secondary Market Practices Committee. In addition to informing the debate on European reform, we hope the paper will be of value to all our members, whether they are involved in trading businesses as owners or as customers.

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Credit Rating Agencies

On 14 January, ESMA published a [call for evidence](#) on the criteria for endorsement (Article 21 (2)(a) of the draft amended Credit Rating Agencies (CRA) Regulation). ESMA was seeking input from all interested parties, in particular CRAs and users of ratings, mainly on those aspects of the endorsement regime which have attracted particular attention or where ESMA perceives there is room for clarification. The responses received, which were required by 24 January, were fed into an 18 March [consultation paper](#) on the future guidelines. The [ICMA has responded](#) in accordance with the 31 March deadline.

Announced on 24 February, there is a [newly published report](#) of the IOSCO Technical Committee on the [Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies](#). This report concerns a review of CRA supervisory initiatives in Australia, the EU, Japan, Mexico, and the United States, which found that while the structure and specific provisions of the different programmes may differ, the objectives of IOSCO's CRA Principles are embedded into each of the programmes.

Dated 23 February, the Eurosystem has [published its reply](#) to the European Commission's [public consultation on Credit Rating Agencies](#). *Inter alia*, this reply says:

"The Commission's paper enquires whether it would be useful for the ECB to provide ratings for regulatory purposes. The ECB should not issue public ratings to be used for regulatory purposes.

Notwithstanding, the Eurosystem fully supports the efforts to reduce the reliance of financial markets and the official sector on CRAs' ratings and to diminish the impact of "cliff effects" of the regulatory use on financial institutions and markets."

Also in relation to this new Commission consultation, there is a 24 November draft report on [Credit Rating Agencies: Future Perspectives](#), from the European Parliament's (EP's) rapporteur, Wolf Klinz. Following debate in the EP's ECON Committee, a [16 March press release](#) stated that this report did not however find unanimous support. The key points of discord were to do with methods for rating sovereign debt and with the structure of the proposed European credit rating foundation.

Dated 17 December, the Committee of European Banking Supervisors (CEBS) [published its advice](#) to the European

Commission on the non-eligibility of entities only producing credit scores for External Credit Assessment Institution (ECAI) recognition. There are certain entities to which the EU's CRA Regulation does not apply and which could, potentially, be eligible to apply for ECAI recognition without being registered in accordance with the EU CRA Regulation – namely central banks and those entities only producing credit scores. It is proposed that there be a specific requirement that an ECAI has to be registered in accordance with the EU CRA Regulation as a precondition for being recognised as an eligible ECAI for capital requirement purposes, implying that entities which are only producing credit scores will no longer be eligible to apply for ECAI recognition.

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

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

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Alternative Investment Fund Managers (AIFM) Directive: Level 2

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

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

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

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

CESR published a [call for evidence on Level 2 measures](#). The AMIC made some [general comments on the implementing measures](#). In particular, the AMIC response highlighted the value of the alternative investment industry to investors. The AMIC believes that maintaining diversity of investment is crucial. There is concern that investors will lose the ability to design optimal investment strategies, and there is a risk that overly burdensome regulation will also result in a reduction in the quantity of funds available, and in a reduction in both the variety of funds and also the quality of funds which EU investors can access.

Given that the official publication of the final Level 1 text has been delayed and is only expected to take place in June, it seems that ESMA will be given more time to develop its advice. Currently, it is expected that ESMA will finish work in November of this year which should provide it with roughly two extra months to finalise its technical advice.

ESMA has divided the work into four separate sub-groups or taskforces. These taskforces have a fair amount of autonomy especially as regards their interaction with the industry, and do not necessarily operate on the same timelines. The one common deadline for all of the taskforces concerns the publication of the draft technical advice which should most likely come out in June or July (originally mid-May) for a two month public consultation period.

The four taskforces formed by ESMA to deal with the various work streams are as follows, with membership of each taskforce drawn widely from EU Member States' national regulators and ESMA staff:

- Depositories – chaired by the AMF, France.
- Scope and types of AIFM – chaired by the Central Bank of Ireland.
- Authorisation/delegation/organisational requirements – chaired by BAFIN, Germany.
- Transparency/leverage/risk/liquidity – chaired by the FSA, UK.

All four of the taskforces report to the ESMA Investment Management Standing Committee (IMSC) which undertakes ESMA's work on issues relating to collective investment management, covering both UCITS and non-UCITS investment funds. This group is chaired by CONSOB of Italy. Final technical advice will be approved by ESMA's Board of Supervisors on the basis of IMSC recommendations.

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Corporate governance

Measures to increase shareholder engagement were the cornerstone of Commissioner Barnier's [Green Paper on Strengthening Corporate Governance in Financial Institutions](#). The governance reform plan is part of the Commission's roadmap to meet commitments made at various G20 meetings to strengthen transparency, responsibility and capital requirements. The European Commission mentions that the financial crisis has revealed noticeable weaknesses in the corporate governance of financial institutions and suggests that timely and effective checks and balances in the governance systems would have helped mitigate some of the risks. The Green Paper explains clearly that the Commission supports the view that previously shareholders did not exercise control over risk-taking in financial institutions they owned.

The AMIC Corporate Governance Working Group has [responded](#) to the UK Government paper entitled [A Long-term Focus for Corporate Britain](#). The AMIC is of the view that Government support for the Financial Reporting Council's (FRC's) Stewardship Code is welcome, together with the FRC initiative to encourage investors to publish a statement on their website of the extent to which they have complied with the Code.

The AMIC has also [publicly supported](#) the [FRC Stewardship Code](#). The members of the AMIC share the view that (industry) codes on a "comply or explain" basis are better suited than rigid regulation to achieve the envisaged higher level of investor engagement. Such codes allow for sufficient flexibility to accommodate different investment strategies, approaches and models while providing asset owners with relevant information on the investment manager's approach to engagement to make an informed decision when appointing a manager.

The AMIC therefore welcomes efforts that have been made in the UK to improve corporate governance standards through market-led initiatives such as the FRC Stewardship Code. The AMIC encourages the asset management industry to adopt the Code. Moreover, the AMIC believes that the European and international dimensions of the corporate debate are key and has urged the FRC to work with the relevant authorities. While the provisions included in the Stewardship Code are specific to the UK, AMIC members believe that the seven principles in the Code have international relevance and could be applied globally. AMIC members are looking to do this and would look to the support of the European institutions and EU member states in so doing.

On 5 April, the European Commission published another Green Paper entitled [The EU Corporate Governance Framework](#). Commissioner Barnier explained at the launch of the Green Paper that "company boards [need] to be more effective and shareholders to fully assume their responsibilities".

The three main themes in the Green Paper are the role of the board of directors, the role of shareholders and how to more effectively apply the "comply or explain" principle when a board decides to deviate from agreed corporate governance principles. The European Commission envisages these three elements to be at the heart of good corporate governance.

Boards of directors: One of the main points in this section is the focus on diversity in Board members' profiles and backgrounds. The Commission expects a Board to comprise members with a range of values, views and sets of competences that will provide effective means to tackle "group-think" and generate new ideas. According to the Commission, more diversity leads to more discussion, more monitoring and more challenges in the boardroom. While the Commission is at this stage to promoting the implementation of mandatory quotas or targets, it clearly states that over the next five years it will "consider targeted initiatives to improve the gender balance in decision making". Much of the latter work will be achieved under the Commission's [Strategy for Equality Between Women and Men 2010-2015](#).

Shareholders: As in the previous Green Paper, the Commission focuses on encouraging shareholders to take an active interest in the company in which they have invested. The Commission explains that technological developments as well as the agency relationship between institutional investors and their managers has contributed to increasing short-termism in capital markets in recent decades and may have hindered long-term investment. The Commission considers introducing rules on more transparency that seek to reveal the remuneration and performance of asset managers. The Commission identifies conflicts of interest – arising where an institutional investor or asset manager, or its parent company, has a business interest in the investee company – and ineffective shareholder cooperation as obstacles to engagement by institutional investors. The Green Paper asks for comments on possible ways to overcome these obstacles. Another key point for the Commission is the protection of minority shareholders and how this can be improved.

The “comply or explain” framework – monitoring and implementing corporate governance codes: The “comply or explain” approach is – according to a Commission survey – seen by most companies and investors as an appropriate tool in corporate governance. This principle stipulates that a company which chooses to depart from a code recommendation must give detailed, specific and concrete reasons for the departure. However, the Commission notes shortcomings in applying the “comply or explain” principle and suggests some adjustments to improve the application of the Code as regards the quality of the explanations given in corporate governance statements and monitoring of corporate governance, possibly by regulatory bodies.

The consultation on the Green Paper will be open until 22 July. The AMIC intends to respond to the Green Paper.

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ETF Working Group

AMIC members have briefly discussed the evolution of the Exchange Traded Fund (ETF) industry. It is recognised that plain vanilla ETFs have become a successful product brand, and are a rapidly growing sector of the market both in size and importance. Council members noted that this is encouraging new types of ETFs to enter the market, with potential implications for the ETF name and possibly even for its acceptance, and the AMIC has therefore decided to set up a Working Group (the AMIC ETF Working Group) to consider this and other connected issues, and to report back. The potential audience consists of regulators, supervisors, market authorities, market participants and end-investors. The potential style is likely to be more of a position paper – ie a description of the market and the main issues that are current – than a policy paper, though previous AMIC papers have included recommendations to policymakers where this is deemed appropriate.

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The ICMA Covered Bond Investor Council (CBIC)

The CBIC has been very active in relation to the latest national legislative developments regarding covered bonds (eg the UK regulated covered bond framework; and a French seminar on *obligations à l'habitat*). The CBIC has also been asked to comment in various forums on European covered bonds; and Tim Skeet made a presentation to the US House of Representatives as part of its hearing on covered bonds on 11 March.

The Financial Services Authority (FSA) and HM Treasury (HMT) published on 6 April *A Joint Review of the UK's Covered Bond Regulation*. The review proposes a number of measures to build on the UK's existing covered bond regime, including the following changes:

- introducing consistent standards of investor reporting;
- requiring issuers to maintain a fixed minimum level of over-collateralisation;
- designating a regulated covered bond programme as backed by only a single asset type in the legislation;
- excluding securitisations as eligible assets for regulated covered bond asset pools;
- creating a formal role of “asset pool monitor” in the legislation;
- changes to regulatory reporting.

Responses to the HMT and FSA Consultation Paper must be received by 1 July. The CBIC intends to respond.

The CBIC is particularly interested in the transparency of the cover pool – and is pushing to ensure that more information, of high quality, is available to investors. Although different investors have different transparency requirements, better transparency in general is needed and requested by all covered bond investors:

- Investors who are new to the covered bonds market are demanding a high degree of transparency.
- Investors who do not have “sufficient” capacity adequately to analyse covered bonds need easily comparable and comprehensive datasets.
- Even experienced covered bond investors have increased transparency standards.

Today, no such list is yet available and even investors keep being asked about their information needs. The CBIC believes that transparency standards should be set by investors to suit investors’ needs. As a purely investor-driven organisation, the CBIC can act independently from both issuers and other market stakeholders.

The CBIC Transparency Working Group has tried to identify key information which covered bond investors would need to make a fully informed investment decision. The list will include: general issuer data; data on the cover pool; and qualitative information (here the issuer is asked to provide certain definitions and calculations regarding the reported data requested, to make it more comparable and comprehensive).

In April, the CBIC will publish its European transparency standards. The information will be distributed to the covered bond community and will be available on the ICMA website. The CBIC will start a public consultation period of seven weeks following the public announcement of this initiative. At the end of the consultation phase comments will be discussed by CBIC members and summarised in a feedback statement. The final standards will be published in September 2011.

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Regulation of the market infrastructure

Expert Group on Market Infrastructures (EGMI)

The European Commission services have set up an [Expert Group on Market Infrastructures \(EGMI\)](#), in which ICMA is participating as an observer. As anticipated, the EGMI's third meeting took place on 4 February, the agenda for which centred around discussion of the form and content for the paper which the group is anticipated to produce. The EGMI's next meeting is scheduled to take place on 28 April. It is planned that the Commission will host a conference later this year, providing a public forum to discuss issues related to the EGMI's ongoing work.

European Market Infrastructure Regulation (EMIR)

Published on 15 September, the Commission's EMIR proposal is a Regulation (ie directly applicable across the EU without the need for transposition by Member States) on [OTC Derivatives, Central Counterparties and Trade Repositories](#). Work on this proposal is currently progressing in both the Council and the European Parliament (EP), following the standard co-decision procedure. The aim is that, in line with G20 commitments, the new rules should be fully in place and operational by the end of 2012.

Albeit that there have already been applicable exchanges of views, the EP's [work on this began officially](#) in the Economic Affairs Committee (ECON) on 28 February, with the presentation of a [draft report](#) by its rapporteur, Werner Langen. The proposed amendments in this report are based on a host of discussions with, and surveys and opinions of, many market participants, regulatory authorities and Member States, on the current state of play with regard to discussions within the Council, and on the [ECB's opinion](#). The amendments relate to scope; derogations; non-financial counterparties; cooperation between national regulatory authorities and ESMA; authorisation for third-country CCPs; interoperability; clearing obligation; and retrospective effect of obligations. A similar list of issues also continues to be debated in applicable Council meetings.

Settlement Regulation and harmonisation of settlement cycles

On 13 January, the European Commission [launched a consultation](#) on Central Securities Depositories (CSDs) and on the harmonisation of certain aspects of securities settlement in the European Union. The purpose of this [consultation paper](#) is to gather input to inform legislative proposals due in June 2011. In order to increase the safety and efficiency of the internal market for securities transactions, the Commission intends to introduce harmonisation of key aspects of securities settlement. The ICMA ERC responded to this consultation, as discussed in the repo segment of this Newsletter; and the [Commission has published](#) over 100 responses that it received.

The HSC Working Group submitted its final report as a reply to the European Commission's consultation on CSDs and on the harmonisation of certain aspects of securities settlement, as also discussed in the repo segment of this Newsletter.

Proposal for a Securities Law Directive

The Commission services have [launched a public consultation](#) to seek stakeholders' views on the harmonisation of the legal framework for securities holding and transactions. The objective of this consultation is to inform the preparation of a formal Commission legislative proposal scheduled for adoption before summer 2011. [ICMA has responded](#), as discussed in the repo and primary markets sections of this Newsletter. The Commission has subsequently published a [summary of responses](#) and made public copies of the responses themselves.

TARGET2-Securities (T2S)

At the start of March, a new issue of T2S OnLine ([No 7, Winter 2011](#)) was published by the ECB. This provides a project status update covering the following topics:

- Framework Agreement;
- First migration wave;
- User connectivity;
- User Detailed Functional Specifications (UDFS); and
- Harmonisation.

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

- an interview with Jesus Benito (CEO of Iberclear) in his capacity as chairman of the task force on smooth cross-CSD settlement in T2S;
- an interview with Paolo Cittadini (CEO of Monte Titoli) on Monte Titoli's strategy for adjusting to T2S;
- Marc Bayle's (T2S Programme Manager's) thoughts on concrete ways in which CSDs can re-shape their systems; and
- an introduction to the NUGs and the important role they play in the T2S project.

At its meeting of 22 March, the [T2S Programme Board](#) approved the launch of a Public Market Consultation of the T2S [UDFS version 1.0](#). Market participants are invited to provide comments by 27 May. The UDFS illustrate the features of T2S from a business perspective, provide details about the application-to-application (A2A) dialogue between T2S Actors and T2S, and give a detailed description of the set of messages processed by T2S. This document represents a major milestone of the T2S programme plan. It is based on the T2S [User Requirements Document](#) version 5.0 released in February 2010 and on the [General Functional Specifications](#) version 4.0 issued in May 2010. The Eurosystem will take into account market comments and will release UDFS version 1.2 at the end of October. UDFS v1.2 will provide the basis on which directly connected T2S Actors will be able to design and build their information systems for communicating with T2S.

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 7 March (and next meets on 15–16 June) for its latest progress review. A T2S info session was [held on 25 January](#) in Frankfurt and another [on 31 March](#) in Cyprus.

Collateral Central Bank Management (CCBM2) project

On 24 February, a [CCBM2 info session](#) was hosted by the National Bank of Belgium. This comprised an introductory presentation; a presentation on how CCBM procedures will change with CCBM2; a panel discussion regarding cross-border tri-party collateral management services in CCBM2; and presentations on the CCBM2 project, business requirements, how counterparties and CSDs interact with CCBM2, and operational day. On 1 March the CCBM2 [Business Requirements Document](#) (BRD) was published.

The timeline anticipates detailed system requirements, an interface guide and a user interface guide in 3Q 2011; testing in 2012; and phased migration in 2013. Some sections of the draft Interface Guide for CCBM2 were also made available on 16 March.

CPSS-IOSCO: Principles for Financial Market Infrastructures

On 10 March new and more demanding international standards for payment, clearing and settlement systems were [issued for public consultation](#) by the Committee on Payment and Settlement Systems (CPSS) and the Technical Committee of the International Organization of Securities Commissions (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](#), 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 "financial market infrastructures" or FMIs). These FMIs collectively record, clear and settle transactions in financial markets.

Compared with the current standards, the new principles introduce more demanding requirements in many important areas including:

- the financial resources and risk management procedures an FMI uses to cope with the default of participants;
- the mitigation of operational risk; and
- the links and other interdependencies between FMIs through which operational and financial risks can spread.

There are also principles covering issues that are not fully addressed by the existing standards. These include new principles on segregation and portability, tiered participation and general business risk.

Published along with the report is a [cover note](#) which sets out some specific issues on which the committees are seeking comments. Comments on the principles are invited from all interested parties and should be sent by 29 July. After the consultation period, the CPSS and IOSCO will review all comments received and publish a final report in early 2012.

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ICMA events and courses

ICMA Retail Bond Workshop, Luxembourg, 3 May

ICMA is organising a half day workshop on the retail bond market in association with ABBL and the Luxembourg Stock Exchange. The context for the workshop lies in the increase in the minimum denomination, from €50,000 to €100,000, allowed for exempt bond issues under the Prospectus Directive. The aim of the workshop is to explain existing and proposed regulation concerning the issuance and sale of bonds to retail clients and to provide information on the range and quantity of bonds available to retail clients.

[Register here](#)

ICMA AGM and Conference, Paris, 25 – 27 May

Registrations for ICMA's 43rd annual capital market conference in Paris are now open. This year the conference programme will feature expert sessions on: coordinated global securities regulation; the factors driving development in capital markets; the balance between liquidity and transparency in OTC markets; the international asset managers' perspective on the changing landscape; and advances in market infrastructure. With contributions from leading industry figures, central bankers and regulators, the ICMA conference offers up-to-date and well informed assessment of regulatory initiatives and their practical consequences for market practitioners, issuers and investors.

The ICMA conference is open both to ICMA members and non-members.

[Register here](#)

Understanding the ICMA Primary Market Handbook, London 7 June

A further half day workshop on ICMA's Primary Market Handbook for the issuance of international debt and debt-related instruments will run in London in June. It will give an overview of the scope and application of the recommendations and also take in recent developments and changes.

This workshop is open to ICMA members and non-members.

Understanding the ICMA 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.

[Register here](#)

ICMA Primary Market Forum 2011, London, 23 June

ICMA's 5th Primary Market Forum will take place on the morning of Thursday 23 June, bringing together the international fixed income community, including borrowers, arranging banks, investors and law firms, to discuss the business issues and regulatory developments affecting the issuance of international debt securities

[Register here](#)

Global Master Agreements for Repo and Securities Lending Workshop, London, 20-24 June

In response to demand ICMA and the International Securities Lending Association (ISLA) will be running a further workshop on the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA). These two master agreements are the essential legal underpinnings of the closely-related repo and securities lending markets. The 3-day workshop will include a detailed review of each agreement, consider common legal issues, and highlight the growing similarities and remaining differences. There is a strong practical aspect to the workshop. Thus, the application of the agreements will be discussed and illustrated with case studies. And in order to ensure a clear understanding of what is being documented, the workshop begins by explaining the operational and basic legal characteristics of the instruments and their markets. The workshop will include the soon-to-be published GMRA 2011.

The Global Master Agreements for Repo and Securities Lending Workshop is an accredited course under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. Solicitors may claim 18 hours CPD credit for their attendance on the whole course.

[Register here](#)

Contact: taevents@icmagroup.org

Summary of forthcoming ICMA Executive Education courses

ICMA has launched two Diplomas, focusing on either Securities and Derivatives or Financial Market Operations. Each Diploma can be achieved by successfully completing one introductory programme, one intermediate programme and two specialist programmes from the relevant Diploma pathway.

Contact: education@icmagroup.org

Introductory programmes

Financial Markets Foundation Course (FMFC)
26-28 September, Luxembourg
21-23 November, London

Securities Operations Foundation Course (SOFC)
1-3 June, London
11-13 October, London

Intermediate programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Residential courses:

1-7 May, Sitges, Barcelona
21-27 August, Seoul, South Korea
16-22 October, Sitges, Barcelona

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

Specialist programmes

Corporate Actions - Operational Challenges
9-10 June, London

Credit Default Swaps (CDS) - An Introduction
26 September, London

Credit Default Swaps (CDS) - Operations
27 September, London

Derivative Credit Risk – Analysis and Management
20-21 June, London

Inflation-linked Bonds and Structures
4-15 June, Brussels

Securities Lending & Borrowing
18-19 May, Brussels

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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**RAISING
STANDARDS
GLOBALLY**

**25-27 May 2011
ICMA Annual General Meeting
and Conference
Paris, France**

Register now

The International Capital Market Association's Annual General Meeting and Conference is a prominent and popular feature of the financial markets calendar. The Association has been hosting the event for more than 40 years.

The event consistently attracts a substantial audience with senior level participants drawn from ICMA's international membership as well as regulatory authorities and governments.

The ICMA AGM and Conference offers insight into the markets via discussions and presentations from experts and market practitioners.

Visit www.icmagroup.org for the programme and list of confirmed speakers.