ICMA

10 March 2017

ICMA RESPONSE TO THE COMMISSION CONSULTATION ON CAPITAL MARKETS UNION MID-TERM REVIEW

INTRODUCTION

1 The International Capital Market Association (ICMA) represents issuers, lead managers, dealers, asset managers, investors and market infrastructure providers in the international capital markets. ICMA has over 500 members. They are based across Europe and globally. ICMA has set standards of good market practice in the international fixed income market for almost 50 years. (ICMA's identification number in the EU Transparency Register is: 0223480577-59.)

2 ICMA welcomes the European Commission's consultation: *Capital Markets Union Mid-Term Review 2017.* ICMA's response follows the order of the Commission's questions, and focuses on the successful completion of those workstreams in which ICMA is involved rather than the launch of new measures:

- Promoting private placements, including by assessing the prudential treatment of privately placed debt in Solvency II.
- Implementing the Prospectus Regulation, bearing in mind – during the next phase of the legislative process at Level 2 – the overarching Capital Markets Union principle of making it easier for companies to enter and raise capital on public markets.
- Reviewing corporate bond and repo markets with a view to improving secondary market liquidity.
- Recognising the Green Bond Principles as a successful market initiative for the organisation of the international green bond market on a voluntary basis.
- Addressing bottlenecks in the supply of projects for infrastructure investment.
- Amending Solvency II to encourage investment through ELTIFs, and rapidly implement changes to the prudential regime to encourage investment in STS securitisation.
- Considering the impact of PRIIPs and MIFID II on existing borrower disincentives to offer vanilla bonds to retail investors.
- Highlighting buy-side concerns about the bail-in regime, which may be affecting banking capacity to support the wider economy.
- Limiting any initiative to harmonise the framework for covered bonds to removing differences between legal regimes in Member States.
- Using the review of EU macroprudential policy to move away from banking-biased thinking about systemic risk.

ICMA's response is preceded by two brief notes on broader themes: the importance of minimising the impact of UK withdrawal from the EU on the Capital Markets Union project; and the importance of ensuring EU global competitiveness.

CAPITAL MARKETS UNION AND BREXIT

3 There is a strong case for the Capital Markets Union project to continue in the EU27 when the UK leaves the EU, as capital market financing represents a lower proportion of total financing in the EU27 than in the UK, and the need for the EU27 to develop capital markets to finance growth is correspondingly greater than in the UK.

4 Even so, the proposed withdrawal of the UK from the EU represents a significant risk to the potential benefits which Capital Markets Union can bring to Europe as a whole, given London's role as an international financial centre. Oliver Wyman, for example, estimates that over 75% of the EU's capital market business is conducted through the UK.[1] London is expected to continue to have an important international role, even if some of London's business moves to different financial centres in the EU27 in response to Brexit.

5 How can the impact of UK withdrawal from the EU on the Capital Markets Union project be minimised?

- EU law will continue to apply in the UK until Brexit day, including new EU legislation between now and Brexit day. The UK Government is due this spring to introduce a Great Repeal Bill in Parliament which is intended to ensure that, on Brexit day, all existing EU law will become UK law. EU Directives are already transposed into UK law. But EU Regulations (and various technical standards which underpin the operation of both EU Regulations and EU Directives) currently apply directly in the UK. They will therefore cease to apply from Brexit day unless the Great Repeal Act provides that they should continue to apply in the UK after Brexit. The Great Repeal Bill is not just a "copy and paste" exercise, and there is also a risk that it will be amended during the course of its passage through Parliament. But the UK Government's intention is that, on Brexit day, capital market regulation in the UK and in the EU27 should effectively be the same.

- The EU27 will also need to reassess how well its financial legislation will function post-Brexit without the UK.

6 The UK Government has proposed that the UK should leave the Single Market when it leaves the EU, but plans to negotiate access to the Single Market as a third country. It remains to be seen whether the UK will remain equivalent with regulation in the EU27 and whether appropriate regulatory and supervisory arrangements can be put in place between the FCA and ESMA. There are some technical difficulties relating to equivalence which need to be overcome during the bilateral negotiations between the UK and the EU27. These are discussed in more detail in the ICMA paper on *The Brexit Negotiations and the International Capital Markets* in the latest issue of the ICMA Quarterly Report: (First Quarter 2017, issue no. 44, dated 10 January 2017). But if negotiations between the UK and EU27 break down, there is a real risk that UK and EU27 regulation and supervisory convergence will start to diverge after Brexit.

[1] Oliver Wyman: *EU Scenarios and the UK Financial Centre:* 2014.

CAPITAL MARKETS UNION AND GLOBAL COMPETITIVENESS

7 It is important to ensure that the EU regulatory framework for financial services remains competitive in relation to the rest of the world. The European Commission should place global competitiveness of the EU regulatory framework at the heart of its Capital Markets Union project.

8 The Commission's consultation focuses on the reform of the EU Single Market from an internal perspective, without emphasising sufficiently the need to ensure that the EU regulatory framework is globally competitive. Firms based in the EU need increasingly to export their products and services to the rest of the world and, in doing so, regulatory costs and constraints are an important factor. The EU also needs inward investment from the rest of the world. This requires a predictable and robust legislative environment. That is not always currently the case. For example, EU legislation on simple, transparent and standardised securitisation risks making the EU uncompetitive and unattractive to non-EU investors.

9 At a time when the new US Administration appears to be giving priority to "de-regulation" and avoiding "over-regulation", the global competitiveness of the EU regulatory framework is likely to be of increasing importance. But the importance of maintaining the EU's global competitiveness should not be seen as engaging in regulatory competition. Rather, it should require intense focus on maintaining effective EU-wide regulation in a manner which is proportionate, and which does not unnecessarily inhibit business flows into or out of the EU. In a globally competitive market place, this will necessitate continued efforts to well balance appropriately determined and applied EU and Member State requirements alongside global standards.

1. FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES

Are there any additional actions that can contribute to fostering the financing for innovations, start-ups and non-listed companies? Please propose complementary policy measures, explain their advantages and illustrate any foreseeable challenges to their implementation.

Promoting private placements

10 ICMA has been very active in the field of private placements, and believes that the European private placement market represents both an important source of long-term privately placed debt finance for medium-sized, often unlisted, companies, and a potential transitional market before these companies subsequently access the larger listed debt capital markets. ICMA coordinates the Euro Corporate Private Placement Joint Committee (ECPP JC) that released in October 2016 the European Corporate Debt Private Placement Market Guide[2], which sets out a voluntary framework for common standards of best market practice for the development of a pan-European private placement market. ICMA is grateful for the support of the European Commission for this Market Guide, and generally for its endeavours to explore and encourage optimal conditions for the growth of this market. ICMA also welcomes the decision by the European Commission to commission a study to identify the regulatory and market barriers to the development of private placements, and plans to facilitate contact between the consultants responsible for the study and the ECPP JC.

[2] http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-products/private-placements/the-european-corporate-debt-private-placement-market-guide/

(i) Mapping of funding options

11 It has become apparent that, from the point of view of SMEs, the forms and availability of funding remain opaque, as well as how to go about obtaining funding. ICMA welcomes efforts by the European Commission for a collaborative platform to facilitate the exchange of best practice, which should also map the various forms and availability of funding. This should go some way to removing the information barriers between SMEs and prospective investors/lenders, a challenge which is acknowledged in the Mid-Term Review. In doing so, ICMA plans to support the promotion of the Market Guide and its contents, aimed more specifically at medium, rather than small-sized, companies.

(ii) Solvency II

12 In its response to the Capital Markets Union Green Paper in April 2015, ICMA stressed the importance of creating a level playing field for investment in private placements by institutional investors throughout the Member States. One area where discrepancies remain in terms of investment profiles as between bank investors and insurance investors lies in the capital charges under Solvency II. The ECPP JC has previously demonstrated existing inconsistencies between the Solvency II capital charges for banks under Basel III rules, as well as for insurers under the rules of the National Association of Insurance Commissioners (NAIC) in US private placement, both of which are lower than for insurers in Europe and in all cases with comparable maturity and risk profiles.

13 Private placement debt is and continues to be an investible asset class. But smaller insurers may find it difficult to assess this market or those for whom private placement is a new asset class. In addition, the Solvency II capital requirements are often cited by insurance investors as a significant investment disincentive. ICMA considers that improving the calibration of the current Solvency II charges may remove the disincentives to investment in this market.

14 The calibrations for capital charges currently assume that investors trade in private placements and are fully exposed to their market volatility. In reality, for buy-to-hold investors such as insurers acquiring private placements to match their long-term liabilities, the exposure is not to market volatility of private placements, but to counterparty default risk, which is not appropriately recognised in Solvency II and should be the subject of further investigative work.

15 In terms of default risk, the Solvency II Working Group, a sub-group which feeds into the ECPP JC, is investigating suggestions that default rates are lower, and recovery rates higher, on private placement than for comparable corporate transactions, with comparability being based on implied ratings. This may also affect the level at which the capital charges are ultimately set.

16 ICMA therefore welcomes the commitment announced by the Commission to assess the prudential treatment of privately placed debt in Solvency II. ICMA is ready to assist the Commission in its assessment process, and hopes that the review of Solvency II will lead to a readjustment of the current long-term calibrations in order to incentivise investment in private placement.

(iii) Credit and scoring information

17 As explained in ICMA's response to the Green Paper, ICMA supports efforts to improve the availability of credit and scoring information for suitably defined and identified medium-sized

companies, which should help the market to develop by facilitating the evaluation of these companies by potential investors.

(iv) Restrictions on institutional investors

18 Private placement may be acquired both directly by institutional investors and through fund structures. There are numerous restrictions in EU Member States for institutional investors (such as pension funds) investing in pooled fund solutions holding illiquid assets, such as prohibitions or tax disincentives on allocating investments into Alternative Investment Funds (AIFs). ICMA welcomes Commission efforts to work with Member States and European Supervisory Authorities to assess the need for a coordinated approach to loan origination by funds, and the case for a future EU framework.

2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS

Are there additional actions that can contribute to making it easier for companies to enter and raise capital on public markets? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

Implementing the Prospectus Regulation

19 The agreement by co-legislators on a new Prospectus Regulation in December 2016 was welcome. As the European Commission moves towards the next phase of the legislative process, it will be crucial that the overarching Capital Markets Union principle of making it easier for companies to enter and raise capital on public markets is borne in mind.

20 In particular, Level 2 disclosure requirements should be calibrated to depend on the needs of the investors at whom the prospectus is targeted and the type of securities. This concept is expressly envisaged in the agreed Level 1 text (see Article 6), but employing it fully in the formulation of *all* relevant Level 2 measures should enable the Commission and ESMA to reduce disclosure burdens for wholesale debt issuers and thereby help to achieve the core Capital Markets Union goal of making it easier for companies to enter and raise capital on public markets. Specific examples of where this may be relevant could be in the formulation of minimum information requirements (Article 13) and requirements for assessing the comprehensibility of a prospectus (under Article 19).

21 The general concept of tailoring disclosure requirements depending on the type of securities and the intended audience is already envisaged in the current Commission Regulation 809/2004 implementing the PD, which contains different disclosure requirements for bonds with a minimum denomination of at least €100,000 and those with a minimum denomination of less than €100,000. Those specific disclosure requirements (currently contained in Annexes IV, V, IX and XIII to the Delegated Regulation) work reasonably well at the moment and we would suggest that those annexes are left unchanged. This is because market participants, particularly in the wholesale bond market, are familiar with the requirements, and so any changes (even those that may appear helpful) will result in increased costs for corporate borrowers in the short term as advisors and national competent authorities develop their understanding of the new requirements. Such increased costs (and possible delays to transactions) should be avoided if the Prospectus Regulation is to be seen as a successful part of the Capital Markets Union project.

22 However, in order to achieve another core aim of the Prospectus Regulation of making prospectuses shorter and simpler for investors, it is likely to be necessary to introduce a more general change at Level 2. This could involve introducing new specific disclosure tests that are differentiated

depending on the type of securities being issued. The minimum information requirements would then only be disclosed if they are pertinent to the new specific disclosure test, which would be determined by the issuer in the context of its own business and the relevant offering of securities. This approach is likely to give the best possible opportunity for issuers to shorten their disclosure (and thereby achieve a key aim of the new Prospectus Regulation) while not affecting investor protection. This will also align with the core Capital Markets Union aim of making it easier for companies to raise capital on public markets.

23 A further general point that should be considered in approaching Level 2 measures under the Prospectus Regulation is the need to avoid overly prescriptive disclosure and approval requirements. Previous experiences (e.g. the PD2 summary regime, which is very prescriptive) illustrate that such requirements can have the unintended consequence of making prospectuses less easily analysable and comprehensible for investors, because market participants and NCAs are constrained by detailed requirements that may not be suitable across the wide variety of prospectuses subject to the EU prospectus regime.

24 ICMA will be continuing to engage with the Prospectus Regulation as the legislative process progresses, and would be very interested in discussing approaches to Level 2 measures in more detail with the European Commission and others.

Reviewing corporate bond and repo markets

(i) Secondary markets

25 ICMA has long been focused on the importance of an efficient and effective secondary market for corporate bonds in supporting access for corporates to the public debt capital markets. The critical relationship between a functioning secondary market and a vibrant primary market is highlighted in ICMA's 2013 paper, *Economic Importance of the Corporate Bond Markets*. ICMA's 2014 report, *The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives From the Market*, was a response to increasing claims, particularly among buy-side firms, that liquidity conditions in the European corporate bond markets were becoming impaired, and a growing concern that the market may not be able to function effectively once the interest rate and credit cycles eventually turn. The study identified the retrenchment of market-making, largely the result of increased regulatory costs of capital, as being the primary challenge to market liquidity.

26 ICMA's second study into the state and evolution of the European corporate bond secondary market, *Remaking the Corporate Bond Market*, published in 2016, focused on how market stakeholders, including broker-dealers, institutional investors and asset managers, infrastructure providers, as well as corporate issuers, were responding to more challenged liquidity conditions, and suggested possible interventions to help to improve the long-term efficiency and functioning of the European corporate bond markets. The key recommendations are summarised below:

- *Provide capital relief for market-making.* Given the heterogeneous and inherently illiquid nature of credit markets, the market-making model is the optimal, and perhaps the only viable, source of true market liquidity. While there are multiple pressures on banks and broker-dealers' capacity or willingness to provide market-making services in bond markets, it becomes clear that the increased cost of capital is perhaps the single biggest constraint. Given the economically important and socially useful service that market-makers provide in supporting the efficiency and functioning of corporate bond markets, policy makers and regulators should at the very least consider the possibility for less stringent capital charges related to this activity, including associated hedging and financing.

- *Revitalise the single-name CDS market*. Single-name CDS not only provides an efficient and standardised tool for market-makers and investors to hedge credit exposures, but given its close relationship with the underlying reference bonds, an active and liquid single-name CDS market could help stimulate liquidity in the corporate bond market. Measures to revitalize the market could include reviewing CVA capital charges and NSFR funding requirements under CRD IV/R.

- *Review and reassess harmful regulation.* It becomes clear that there are a number of regulatory initiatives that seem to offer no obvious benefits to fixed income markets, and, in certain cases, are likely to cause significant harm. There is a strong case for suspending the projected implementation of these regulatory initiatives with a view to undertaking rigorous and detailed impact analyses.

- *Bring all market stakeholders together to review the market structure.* All market stakeholders, including investors and asset managers, corporate issuers, banks and broker dealers, intermediaries and infrastructure providers, relevant market associations and representative bodies, as well as policy makers and regulators, need to work together in a formalized and structured forum to share views and ideas on market structure and development. Only through a greater understanding and appreciation of different stakeholder needs and perspectives can the market community achieve consensus and develop private and public initiatives to maintain and grow a healthy and vibrant pan-European corporate bond market.

(ii) The market-making function

27 From ICMA's ongoing interaction with various market stakeholders, it is clear that, despite market initiatives related to technology, data, and connectivity, including electronic trading and matching facilities that promote "all-to-all" trading, as well as buy-side behavioural changes that enable their provision and sourcing of market liquidity, liquidity in the corporate bond secondary markets is still very much reliant on the market-making model. The intrinsically disparate, heterogeneous, and long-term nature of corporate bond markets does not lend itself easily to the exchange-based model that underpins liquidity in more homogenised markets such as equities or financial futures. For the most part, the immediacy that investors require can only be provided by broker-dealers willing to act as market-makers.

28 ICMA believes that, while new initiatives and protocols that reduce dependency on the market-making model should be fully explored and encouraged, there is still an important need to support, and even revitalise, the market-making function of banks and broker-dealers. The retrenchment of banks and broker-dealers from providing market-making services, and the evolution of traditional liquidity providers from principal traders to principal brokers, is now well recognised. While the forces driving this are multiple, and often difficult to isolate, it is clear that the regulatory impacts on the cost of capital required to support market-making is proving to be the primary constraint. This not only relates to the cost of dealers holding long or short positions, but also the associated costs of hedging and financing their positions. Thus, the regulatory impacts on the functioning and efficiency of both the single-name CDS market and credit repo market are also of critical importance when considering the disincentives to market-making.

29 A question often raised is why the increased regulatory costs of providing market-making services (including the associated hedging and funding costs) are not simply passed on to investors through

dealers' bid-ask spreads. However, this would assume a risk-neutral model, where dealers simply reprice for their risk weighted capital and other costs. What becomes clear from discussions with sell-side firms is that we are far from a risk-neutral environment, and banks now operate within a highly risk-averse culture. Where a business line ceases to generate the required returns on capital, rather than reprice, it is optimal to reallocate limited capital and resources away from that business and into areas that do meet the requisite returns. This observation holds equally true for both repo and CDS market-making.

(iii) Repo and collateral

30 ICMA wishes to underscore that the repo market plays a vital and central role in the modern financial ecosystem, facilitating a number of critical functions and interacting with a variety of different financial markets. Beyond providing a means for secured short-term borrowing and lending, the repo markets are essential for funding the market-making books of broker-dealers for both sovereign and corporate debt, and so play a key role in underpinning secondary market liquidity for global bond markets. Similarly, repo markets are the glue that binds many derivatives with underlying cash securities, in particular exchange-traded bond futures and options. Liquid and efficient derivatives markets are relied upon by both financial and corporate institutions to hedge and disseminate their interest rate exposures. Often overlooked, the repo market is also where collateral is priced, sourced, and mobilised, allowing a whole range of financial and corporate institutions to meet the margining requirements that increasingly underpin today's financial markets. Finally, the repo market is the primary channel through which central banks target bank reserves and transmit monetary policy.

31 It soon becomes clear that the ability for the repo market to function efficiently and effectively is essential for the overall health of the capital markets through which governments and corporates raise funding and whereby investors and savers can earn returns and capital growth. In many ways, the repo market represents the foundation stone of the financial system that facilitates investment, employment, productivity, and economic growth. To interfere with the repo market is to tamper with the DNA of modern-day capital markets. Yet this is precisely what the confluence of various regulatory initiatives appears to be doing.

32 ICMA's concerns about this have been repeatedly highlighted over recent years. Discussion of an initial ICMA paper in 2013, *Avoiding Counterproductive Regulation in Capital Markets: A Reality Check*, quickly led to the conclusion that collateral was a vital element to be further explored. Consequently, in 2014, ICMA published the paper, *Collateral is the New Cash: The Systemic Risks of Inhibiting Collateral Fluidity*, which addressed growing concerns related to the potential for systemic collateral demand-supply imbalances as a result of regulation. The report concluded that while the demand and supply of collateral is inherently dynamic, and so cannot be predicted, demand-supply imbalances should not be a threat, even under stressed scenarios, so long as the ability for collateral to move through the system (ie "collateral fluidity") is not inhibited.

33 The paper noted that collateral fluidity requires both robust and efficient settlement infrastructure (the "plumbing"), as well as bank funding desks that are able to source, price, manage, and mobilize collateral (the "pump"). It highlighted the potential risks arising from existing and proposed regulation (including CRD IV/R Leverage Ratio and NSFR, CSDR mandatory buy-ins, SFT reporting, mandatory hair-cuts, mandatory clearing, collateral ("re-")use restrictions, and the Financial Transaction Tax) that would limit the ability of bank repo desks to provide liquidity to the repo market and so support collateral fluidity, particularly under stressed conditions.

34 Then, in November 2015, ICMA published the paper, *Perspectives From the Eye of the Storm: The Current State and Future Evolution of the European Repo Market*, which illustrates how regulation is already dramatically impacting the way in which repo desks are able and willing to provide repo market liquidity, primarily in response to the new regulatory framework. The study concludes that, while predicting the future evolution of the European repo market is difficult, since it is predicated on too many unknowns arising from both regulation and monetary policy, there are a number of consensus views. These include an expected reduction in the size of the market, an increase in the diversity of participants, a general widening of bid-ask spreads, and the ongoing merging of banks' funding and collateral management functions. However, the overriding concern among market participants is that in the future, although they expect the repo market to continue in some form, it may be unable to function as effectively and efficiently as it has in the past in providing liquidity and collateral fluidity to the financial system. This has potential negative consequences both for markets and the broader global economy.

35 The evidence that more needs to be done to rectify these concerns is continuing to build. In its short – February 2017 – paper, *Closed for Business: a Post-Mortem of the European Repo Market Over the 2016 Year-end*, ICMA reviews the extreme volatility and market dislocation experienced in the euro repo market over the 2016 year-end, which were unprecedented in the post-euro era. This report attempts to document the market moves and behaviour in the final week of December of 2016. More specifically it seeks to answer: (i) what happened? (ii) why did it happen? and (iii) what possible measures can be taken to avoid future extreme dislocation?

36 The paper finds that it is reasonable to conclude that, at the end of December, the euro repo and short-term funding markets effectively broke down, something that did not happen either during the Lehman crisis or over the sovereign bond crisis. The factors driving this break-down are multiple, but a shortage of readily available HQLA as a result of quantitative easing and the reluctance, or lack of capacity, of banks to provide year-end funding liquidity are key contributors. As the ECB's bond purchase programmes are set to continue, and as more regulation puts pressure on banks' balance sheet and intermediation capacity, there is a very real concern that the market behaviour over the 2016 year-end is not a "one-off" event, and could herald the start of a new normal.

37 This could heighten risks related to banks' and firms' ability to meet margin calls, which in turn could have systemic consequences. It seems unlikely that one single solution, either by regulatory or monetary policy makers, will provide a quick fix; rather it is likely to require a number of measures as well as more rigorous, ongoing analysis of the possible impacts of various policies, in order to ensure the smooth and efficient functioning of the European funding and collateral markets. Already this is making it difficult for investors to smoothly finance their requirements and is sapping the effective operation of secondary markets. These factors will in turn serve to undermine the efficiency of the primary bond market, raising financing costs for governments and businesses alike.

(iv) Reviewing regulation

38 ICMA welcomed the European Commission's Call for Evidence and was pleased to respond, with particular focus on the issue of market liquidity, where ICMA was able to draw on its extensive work related to both the European corporate bond market and the European repo market. In its response, ICMA highlighted the potentially harmful effects of certain regulatory calibrations on market liquidity, in particular, elements of CRD IV/R (more specifically Leverage Ratio, NSFR, and FRTB), as well as the CSDR provision for mandatory buy-ins.

39 While ICMA welcomes many of the positive recalibrations, and phasing-in, of certain aspects of CRD IV/R, it feels that much more could be done to improve market liquidity without compromising

the overall objectives of the Regulation. The elimination of the asymmetric treatment under NSFR for short-term lending and borrowing with banks and financial institutions would be an important recalibration in this respect, as further elaborated on in ICMA's – June 2016 – NSFR comment letter to the Commission; while a separate, more dynamic, Leverage Ratio for securities financing transactions in high quality liquid assets, as further elaborated on in ICMA's – July 2016 – Leverage Ratio comment letter to the BCBS, would help to support fluidity in the short-term funding and collateral markets (which in turn would be positive for both bond and derivatives markets).

40 ICMA also recognises the significant work undertaken by ESMA and the European Commission in drafting the regulatory technical standards for the CSDR mandatory buy-in regime, particularly given the challenges posed by the Level 1 text. However, it is clear through discussions with ICMA's sell-side members that the mandatory requirement to initiate buy-ins will create additional risks and frictions to market-making, while ICMA's buy-side members express concern that the regulation unfairly penalises them by widening bid-ask spreads for more liquid bonds and restricting offer-side liquidity for less liquid instruments (in particular, corporate bonds). They further note that the mandated cash-compensation default creates an additional layer of unquantifiable market risk for them when purchasing securities. The disincentive to market-making is further compounded by an explicit asymmetry in the regulatory provisions for the settlement of the buy-in proceeds, which disproportionately penalises the failing party in the event of a falling market. Perhaps not intentionally, this asymmetry also penalises any principal intermediaries, who are not responsible for the fail, but who happen to be part of the settlement chain.

41 The implications of the mandatory buy-in regime for bond market pricing and liquidity are outlined in a 2015 ICMA impact study for mandatory buy-ins, while the effects of the asymmetric treatment for the buy-in and cash compensation payments are illustrated in a 2016 ICMA white paper. The recent consultation on ICMA's own buy-in rules (which apply to non-cleared cross-border fixed income transactions), which involved both sell-side and buy-side market participants across a range of fixed income asset classes, has resulted in a modified buy-in framework that is more flexible, less prescriptive, and resolutely discretionary rather than mandatory. This further corroborates the broad opinion that the CSDR buy-in regime will be extremely detrimental to European corporate bond market liquidity.

(v) Bringing stakeholders together

42 A clear message from ICMA's studies is the need to bring different market participants and stakeholders together in a bid to understand better the various perspectives and priorities, and to help facilitate an evolving market structure that continues to support an efficient and effective pan-European corporate bond market. ICMA, as a market body, is able to provide such a platform, and endeavours to do so through its various committees and working groups, engaging banks and dealers, institutional investors and asset managers, corporate issuers, as well as trading platforms and other infrastructure providers.

43 The initiation of the European Commission's Expert Group on Corporate Bond Market Liquidity provides an official platform for cross-stakeholder dialogue and the opportunity for market representatives to provide recommendations to policy makers in order to support the common goal of an efficient and resilient pan-European corporate bond market. Accordingly, ICMA applauds this initiative, is pleased to be an active member of the Group, and looks forward to the finalisation of the Group's report, and the culmination of its work, later in 2017.

3. INVESTING FOR LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT

Are there any additional actions that can contribute to fostering long-term, infrastructure and sustainable investment? Please propose complementary policy measures, explain their advantages and illustrate any foreseeable challenges to their implementation.

Sustainability

(i) Sustainable finance and green bonds

44 The international green bond market that reached in excess of $80 billion in issuance in 2016 is making a substantial contribution to the growth of sustainable finance as well as to the development of best practices in areas such as transparency, green project definitions, impact reporting and the use of external reviews, reflected in the Green Bond Principles (GBP) for which ICMA provides the Secretariat. The overwhelming majority of green bonds represent balance sheet financing with the risk remaining on the issuer rather than on the underlying project. Green bonds are therefore not any more than mainstream bonds specifically tailored for long-term and infrastructure investment. The key distinctiveness of green bonds is the transparency provided on the use of proceeds for eligible green projects. Green bonds can also facilitate the redistribution of capital to environmental and sustainable projects by providing a recognised green asset to the investor community. They illustrate how capital markets can support the wider transition to a sustainable economy that remains, however, contingent on the application of the full spectrum of available policy tools such as, for example, research to drive consensus on green taxonomies, fiscal policy to stimulate underlying public and private green project flows and carbon pricing.

(ii) HLEG

45 Concerning sustainability, ICMA welcomes the creation of the European Commission's High Level Expert Group (HLEG) on Sustainable Finance where it participates as an observer. ICMA believes that the HLEG should consider recommendations such as the recognition of the GBP as a successful market initiative for the organisation of the international green bond market on a voluntary basis; seeking consensus on a high level taxonomy for green projects and use of proceeds based on the green project categories of the GBP and the work of other key stakeholders in the green bond market such as the multilateral development banks and the Climate Bonds Initiative; and proposals for a range of possible incentives for green bond issuers and borrowers, as well as for green bond investors and creditors, including regulatory relief to be reflected in possible dedicated recalibrations of CRD IV/R and Solvency II.

Infrastructure investment

(i) EFSI

46 ICMA considers that extension of the European Commission's European Fund for Strategic Investments (EFSI) is a welcome initiative in furtherance of investment in, and financing of, infrastructure, and that the Commission should continue to acknowledge the needs of private capital and build the appropriate environment to encourage institutional investment in Europe's infrastructure. In this regard, there may be an increased role for both national governments and national infrastructure banks in developing a more conducive environment for private investment by enhancing market awareness. For example, if commissioning authorities partnered with national

infrastructure banks and the private sector (whether banks, insurers or other investors) to ensure procurement processes reflect investor needs, this would help to develop ”investor-ready” projects.

47 The European Investment Project Portal (EIPP) is a significant step in giving visibility on transaction flow, highlighting investment potential and therefore stimulating a transparent pipeline. The creation of the comprehensive technical assistance programme under the coordination of a European Investment Advisory Hub (EIAH) is also welcome.

48 The development in each Member State of a governing body such as a national infrastructure commission could be beneficial to ensure accountability over implementation and infrastructure policies, to coordinate with EFSI priorities and to challenge policy changes which may endanger long-term investment decisions.

(ii) Pipeline

49 Mindful of the role of the EIPP, the fundamental bottleneck overwhelmingly cited for infrastructure investment is the supply of projects. There is no shortage of finance, but a significant shortage of bankable deals – plus competition for whatever deals there are – is a challenge. However, creating the optimal conditions for infrastructure financing, such as those set out below, may serve to help stimulate the pipeline.

(iii) Solvency II/CRR and infrastructure

50 ICMA welcomes the Commission’s recent efforts to establish an infrastructure project asset class for which insurers benefit from reduced capital charges. A reduction in capital charges for infrastructure investments in corporate form is likely to have a substantial impact in financing infrastructure and attracting more private capital into infrastructure investments within EFSI. Well-structured infrastructure projects have been proven to be less risky than normal corporate credits, and should logically therefore require less capital to be set aside against them. For this reason, ICMA supports ongoing efforts on reviewing the calibration of risk charges for infrastructure corporates and will continue to contribute to the debate.

(iv) ***Regulatory uncertainty***

51 Fundamentally, investors need to have some comfort as to long-term regulatory and policy stability in order to protect underlying revenues. Regulatory uncertainty in one jurisdiction can also have a contagion effect on investor confidence in other jurisdictions. A move towards transparency and consistency on the part of regulators and public sector authorities with regards to maintaining tariff-setting and/or other regulatory controls would help to assuage investors' concerns over the regulatory risk associated with the underlying revenues of the project.

(v) Procurement

52 From the point of view of deliverability of funding, as well as to be able to ascertain relative value for money, it is important that a procurement authority secures committed financing at an early stage, which is not always possible in bond financing. In order to create a level playing field as between bond and bank financing for infrastructure, ICMA recommends a review of national procurement legislation, in particular how the concepts of “deliverability of funding” and “value for money” are to be quantified.

(vi) *Performance monitoring*

53 Infrastructure is a specialised area requiring expert knowledge and experience to ensure prudent long-term investment at all stages – from financial close of the financing to completion of the project and beyond. This requires long-term thinking, long-term structuring and long-term monitoring of the projects' performance. Absent monoline insurers, and with projections for infrastructure investment high, there may be a case for regulatory impetus to appoint a particular body (new or existing) to undertake the specialist role of performance monitoring.

(vii) Disclosure

54 An important factor that would make it easier for investment decisions to be reached on infrastructure investment is more and better disclosure. While the asset class may not be capable of being standardised, regulators could require a consistent and comparable level of data (for instance, as a starting point, on cashflows, probability of cash flow and defaults), as well as better availability of data. In addition, a means of controlling availability of data and keeping the project information fresh is key to unlocking secondary market liquidity in infrastructure finance, where currently the only information available is already stale. Opening up the secondary markets for infrastructure products will help to unlock the pipeline, with more projects resulting in more liquidity.

55 In addition, the published decisions of the EFSI Investment Committee include only a basic description of the EFSI operations approved. They do not explain the reason for granting the EU guarantee, or the EU added value from a particular operation. The scoreboards for the approved operations are not published. This information would be valuable to investors, and its publication would bring about greater confidence in investing in specific projects.

Solvency II

(i) ELTIFs

56 ICMA's Asset Management and Investors' Council (AMIC) strongly welcomed the revisions to Solvency II introduced by Commission Delegated Regulation 2016/467 which revised capital calibrations for infrastructure equity and debt and revised the treatment of ELTIFs to reflect that of European Venture Capital Funds (EuVeCas) and European Social Entrepreneurship Funds (EuSEFs). This was a helpful step to facilitate insurers' investment in long-term illiquid assets. It also acted as a political signal that investors could look more favourably on long-term investment.

57 ICMA notes and welcomes the commitment by the Commission to revise the prudential treatment of private equity and private debt, which should help the European private placement market. However, ICMA believes that there are additional actions with regard to Solvency II that must be taken to further improve long-term investment and to close the investment gap that exists in Europe.

58 For ELTIFs to become more successful, alongside EuVeCas and EuSEFs, the Commission should consider amending Solvency II to give a more comprehensive recognition of the long-term illiquid investments involved, and not merely to equity investments. Such a reform should give a "wrapper" discount for ELTIFs, EuVeCas and EuSEFs to recognise the illiquid nature of the investments within them and therefore de-emphasise liquidity risk in the spread risk module.

59 Such an approach would have the advantage of a simple, easy to understand, boost to these kinds of funds and should lead to greater asset allocation to illiquid investments by insurers and other long-term investors as a result. However, the challenge is that the wrapper advantage would not take into

consideration the nature of the underlying assets, so it would need to be carefully calibrated so as not to distort investment in illiquid assets.

(ii) STS securitisation

60 Many insurers have exited the European securitisation market because of the punitive treatment of even senior tranches of ABS under Solvency II. ICMA's AMIC believes that the Commission should not delay launching its intended amendments to the Solvency II Delegated Act to recognise the simple, transparent and standardised (STS) securitisation regime. The Commission should ideally not wait until the legislative procedure is finalised for STS securitisation, and at the very least should not wait until the general review of Solvency II to change the prudential regime for high quality securitisation. The longer the current capital calibrations for securitisation are in place, the less likely it is for insurers and other long-term investors to re-enter this important asset class for European growth and jobs.

61 A number of insurers have stopped investing in securitisations, and some have even wound down positions altogether. In addition to the concerns over the calibration of the risk weights, there is a likelihood (post finalisation of STS) that the Type 1/2 designation will change. Therefore, there is limited incentive for issuers or investors to spend time and money trying to ensure systems and processes comply with cumbersome rules that may be obsolete within a couple of years.

62 Now that insurers have entered into compliance with Solvency II, ICMA's AMIC believes that the next step will be for insurers to think about "optimising" their capital structure. Given the treatment of securitisation, it is entirely possible that there will continue to be anaemic interest in the asset class and potentially even further moves away from investing in securitisation as the Solvency II regime beds down. Whilst it is possible that once STS is finalised, if the concerns around issues such as interpretation and capital are addressed, the insurance community will look to return to the class, there must be a question whether it will still exist.

63 If any investor is faced with a choice between investing in a securitisation, or another investment with a similar risk/return profile (eg even certain investment grade debt), it is not clear why the investor would choose the investment with potentially adverse capital weighting and cumbersome regulatory compliance burden attached to the investment process.

4. FOSTERING RETAIL INVESTMENT AND INNOVATION

Are there additional actions that can contribute to fostering retail investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

64 In the context of the Single Market for retail financial services (perceived in the consultation not to be performing to its full potential), it is noted that "the new product disclosure rules under MiFID II, PRIIPS and IDD need to be put to work and effectively support retail investors in their investment choices." However, it seems increasingly likely that the practical impact of the PRIIPs and MiFID II product governance regimes will be to reduce the availability of "vanilla" bonds to retail investors by further[3] disincentivising borrowers who can meet their funding needs more simply elsewhere to support the economy. In this respect retail investor fixed income choices seem likely, with exceptions (potentially at national level), to be limited in future to discretionary managers (for the wealthy) and otherwise UCITs/funds, structured products and "exempt" government bonds. So there seem to be

[3] For other disincentives, see paragraphs 91-103 in the 30 April 2015 ICMA response to the European Commission Green Paper on *Building a Capital Markets Union.*

existing actions that may contribute to hindering retail investment, which the Commission may wish to review.

5. STRENGTHENING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

Are there any additional actions that can contribute to strengthening banking capacity to support the wider economy? Please propose complementary policy measures, explain their advantages and illustrate any foreseeable challenges to their implementation.

Bail-in

65 The ICMA Bail-in Working Group (BIWG) is a buy-side group which seeks to provide a constructive voice in the debate on the future shape of banks' balance sheets. The BIWG is concerned that extra layers of complexity surrounding the operation of the bail-in regime may not only make it more difficult for banks to raise capital, but also ultimately negatively impact investor demand, and thereby potentially render specific tranches of bank debt uninvestable. This in turn will impact banks' ability to raise new capital in support of new lending and therefore on their ability to support the economic recovery.

66 Aside from non-performing loans (which are addressed further below), these layers of complexity include: lack of transparency, complexity of capital structures leading to inability to price credit and risk, difficulties in achieving subordination and lack of consistency. The BIWG has compiled a number of position papers which have been presented to, *inter alia*, officials at the European Commission and the European Central Bank[4].

(i) Non-performing loans (NPLs)

67 The BIWG agrees that high levels of NPLs remain a challenge in a number of Member States, leading to concerns that investors may be called upon to fund these bad loans many years after the onset of the financial crisis and as part of the bail-in/resolution of a bank.

68 In terms of solutions, the BIWG agrees with Danièle Nouy's comments in a letter to Members of the European Parliament on 28 June 2016: "Non-performing loans (NPLs) have reached elevated levels in several Member States … there is no one-size-fits-all solution to the NPL problems. … [National and European legislative authorities] should consider streamlining legal processes related to debt recovery, removing impediments to the enforcement of loan collateral, introducing out-of-court debt work-out solutions, and fostering the development of distressed debt markets."

(ii) Transparency

69 Any moves to improve transparency, disclosure and harmonisation of accounting for NPLs would go some way to improving investor confidence. Fixed income investors consider that consistent transparency and disclosure of data is vital, as to which a unified, detailed and publicly disclosed chart of accounts and financial reporting for banks in the euro area would help. Similarly, a regulatory

[4] http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Primary-Markets/primary-market-products/bank-capital/

requirement for parity of reporting and transparency of a bank's debt structure, including asset encumbrance levels, as between the regulatory authorities and the market would encourage market discipline, and go some way to assuaging bondholders' concerns over consistency of information.

(iii) ***Complexity of capital structures***

70 There are two critical elements for assessing bank credit risk: (i) determining the likelihood of a bail-in (probability of default) and (ii) the size of a potential loss (loss-given default).

71 In order to assess the probability of default, an analyst will evaluate the "point of non-viability" (PONV). However, as well as PONV, regulators have set a number of triggers but provided relatively little guidance on them (such as Minimum Requirement for Eligible Liabilities and Total Loss Absorbing Capacity), meaning that the location of these triggers along a now more complex, revised capital structure is not entirely clear (and may indeed be varied through time).

72 An assessment of loss-given default requires an evaluation of a bank's capital stack to evaluate exposure. However, thorough balance-sheet analysis of banks has become more complicated, so any moves to standardise key definitions, especially around NPLs etc., would be welcomed.

73 Generally, the absence of standardisation/homogeneity, and of a track record of interventions, leaves investors with little insight and, consequently, it is difficult for them to price the occurrence of all such contingencies in a reasonable way.

(iv) ***Achieving subordination***

74 There is not yet a consistent or clear methodology on the manner in which subordination of bail-inable debt will be achieved across the Member States; whether by structural, contractual or statutory subordination. Although the risks to bondholders will be broadly similar in terms of the probability of bail-in, a consistent, predictable approach to subordination applied on a pan-European basis would significantly ease the challenge for the buy side, as well as easing the complexity of resolving cross-border banks.

(v) ***Consistency***

75 Inconsistencies over the application of bail-in at a political, regulatory and national discretion level create investor confusion and market distortion, which in turn have an effect on the pricing and marketability of bank securities. This serves to amplify the importance of consistent, clear communication and disclosure requirements which should be harmonised across jurisdictions.

STS securitisation

76 ICMA's Asset Management and Investors' Council (AMIC) believes that the reform of securitisation markets is the most important policy element under consideration in strengthening banking capacity to support the wider economy. Securitisation is important for many investors, and therefore it is important for the long-term savings of European citizens. Investable asset classes like securitisation are critical in today's ultra-low interest environment.

77 It is therefore regrettable that a very helpful proposal by the European Commission to create a simple, transparent and standardised (STS) securitisation framework has become delayed and potentially rendered irrelevant by difficult discussions among the co-legislators. The AMIC believes

that the efforts by the Bank of England, European Central Bank (ECB), the European Banking Authority (EBA) and now the European institutions to create the "high quality" STS label of securitisation is the right way to bring back investors to the asset class and to revive securitisation in Europe.

78 The main benefit for investors of a higher quality label is the potential for more sensible capital requirements for securitisations issued under the label under Solvency II. Therefore, the AMIC regrets the delays to a proposal to amend the Solvency II Delegated Acts to reflect this, as noted above.

79 The AMIC is also concerned that the debate in the European Parliament, in particular, has taken the STS proposal in an unhelpful direction that risks the viability of European securitisation issuance and investment. European Parliament-led ideas on investor name give-up, restrictions on permitted investors and unhelpful changes to risk retention risk fatally undermining the goal of the original proposal. From an investor perspective, if the goal posts for risk retention are constantly in flux or needlessly complex, they serve largely to create significant further uncertainty about the ability of investors to comply with their own regulatory requirements.

80 To reap the benefits of a well-designed STS securitisation package, the Commission needs to play its part in the difficult legislative process to ensure that the legislation helps rather than hinders the revival of EU securitisation markets. The Commission should also rapidly implement changes to Solvency II to reflect the changes to securitisation in the STS proposal – otherwise, there is a real risk that insurers, long an important investor base in European securitisation, do not return to the market in future.

Covered bonds

81 ICMA's Covered Bond Investors' Council (CBIC) has supported the Commission's initiative on covered bonds but notes that investors were not unanimously supportive of a legislative approach at the EU level. In the CBIC's response to the European Commission's consultation on covered bonds, some CBIC members believed that voluntary convergence of national regimes would suffice, particularly if backed by measures like capital requirements referencing the best practice guidelines. Other CBIC members expressed a preference for an EU legal framework with minimum standards based on current best practice.

82 In general, CBIC thinks that covered bonds in Europe should reflect differential credit risks in different countries. In other words, investors want to continue to be able to price different countries' covered bonds differently depending on prevailing credit risks. Therefore, legislative initiatives to harmonise covered bond frameworks should only seek to eliminate those risk characteristics which are a function of differences between legal regimes in Member States, not risks which are a function of, for example, different underlying risk characteristics of the assets or different commercial models. A market where all covered bonds price at the same level independent of issuer-specific and asset-specific risk factors is neither a practical nor a desirable outcome of this process.

6. FACILITATING CROSS-BORDER INVESTMENT

Are there additional actions that can contribute to facilitating cross-border investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

Macroprudential review

83 ICMA's Asset Management and Investors' Council (AMIC) has taken part in the European Commission's consultation on a macroprudential policy review. Although welcoming the consultation's intent, the AMIC cautioned the Commission against considering the expansion of the European Systemic Risk Board's (ESRB) mandate beyond banking without careful consideration of the structure of the ESRB. A rapid expansion of the ESRB's mandate and powers could lead to inappropriate understanding of non-banks and their potential risks related to financial markets. An expansion of risk analysis and recommendations to non-banking without sufficient analysis could be damaging to the economy and to investors and so undermine the goals of the Commission's CMU initiative.

84 ICMA's AMIC also has a broader concern about the governance of the ESRB, which does not ensure an equal balance between the three areas of financial market supervision (banking, insurance and securities markets). The banking voice is disproportionately powerful. This imbalance should be addressed before the role of the ESRB is expanded.

85 If regulators and supervisors propose to examine the risks involved in non-banking, especially asset managers, the AMIC believes that they should examine the risks involved in financial market activities more widely. Such a holistic approach to market-wide risks should involve assessing the market impact of the activities of all market participants whatever their profile. Given the agency nature of the asset management business, systemic risk is not necessarily proportionate to the size or profile of market participants. It is from this perspective that the AMIC believes the review of EU macroprudential policy is an opportunity to move away from banking-biased thinking about systemic risk.

86 In order to be in a position to examine risks as a whole, internal cooperation within the European Commission needs to be enhanced to ensure consistency in policy making, especially when proposing new legislation that has a broad impact. Investors are often concerned about the impact on them of legislation that is not intended to be targeted at the buy side: eg the legislative proposal on the recovery and resolution of central counterparties affects buy-side activities in derivatives.

Post-trading environment

87 ICMA is a member of the European Post-Trade Forum (EPTF), represented through the Chairman of the ICMA European Repo and Collateral Council, Godfried De Vidts, and has actively contributed to the work primarily from a repo and collateral perspective. ICMA strongly supports the work of the EPTF, which is important for addressing long-standing barriers in the EU post-trade environment; and ICMA encourages the Commission to be ambitious in translating the resulting recommendations into concrete policy actions and proposals.

ICMA
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