ICMA
International Capital Market Association

Unit H2: Banks and Financial Conglomerates II
DG Markt
Rue de Spa 2,
1000 Bruxelles

11 July 2013

Dear Sirs,

**Response submission from the International Capital Market Association (ICMA)**

**Re: European Commission consultation on reforming the structure of the EU banking sector**

**Introduction:**

The ICMA[1] is a pan-European self regulatory organisation and an influential voice for the global capital market. It has a membership of over 420 firms and represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges and other venues, central banks, law firms and other professional advisers. The ICMA's market conventions and standards have been the pillars of the international debt market for well over 40 years.

The ICMA notes that on 16 May 2013 European Commission opened a consultation on reforming the structure of the EU banking sector. The ICMA further notes that this document focuses on the structural separation recommendation of the Liikanen High-Level Expert Group ("the Group"), which was received by the European Commission on 2 October 2012.

**Commentary:**

When the Group's report was received in 2012 the European Commission launched a consultation on the recommendations which it contained. The ICMA responded to this earlier consultation on its closing date of 13 November 2012; and a significant portion of that earlier ICMA response was related to the topic of structural separation which forms the focus of this current consultation. Given the continued significance of the ICMA's previous comments, the applicable section of that earlier ICMA response is repeated in full as an annex to this response and the ICMA respectfully requests that this be considered as a fully integral part of this current response submission.

[1] For more information regarding ICMA please go to http://www.icmagroup.org/

Noting the existence of several other official initiatives concerning similar issues, the ICMA would like to underscore its concern that, given the inevitably elements of overlap amongst these initiatives, there is a risk that any final proposals which do emerge may not necessarily all fit neatly together – either with respect to their content and/or their timing. In order to address this risk, the ICMA considers that it is essential that every effort be made to sustain on-going dialogues – both between the requisite officials and with the markets – and ICMA accordingly welcomes this current consultative process. It is in everyone's best interests that necessary issues are adequately addressed, whilst at the same time avoiding any unnecessary adverse implications for the international capital market.

In overall terms, the ICMA considers that a recommendation to separate securities trading activity, thereby isolating it from primary market activity, would have potentially significant adverse impacts on the international capital market. Given its direct relevance to the international capital market, which is the ICMA's specific area of competence, this response focusses specifically upon this point; and is therefore directly pertinent to question #5 of the consultation.

The ICMA believes that in a thriving and efficient capital market, primary and secondary market trading activities play symbiotic roles. A healthy flow of primary market origination helps to stimulate secondary market trading, whilst improved liquidity in secondary markets helps to underpin investor confidence and thus boost conditions for new issuers. Separation of these activities may impede this interrelationship, thus harming overall conditions for financing, whilst at the same time not in itself delivering dramatic improvements to either the safety of the system or of investors. Furthermore, these concerns cannot be dealt with simply by moving both primary and secondary market trading activities out from banks, as this would create a significant stress on underwriting capacity.

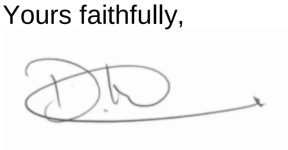
At the current time it is apparent that, more than ever, Europe needs a thriving and efficient capital market[2], able to meet the challenges of funding real economy needs whilst European economies' former dependence on funding through the channel of bank lending continues to diminish. The ICMA is convinced that this is already a major challenge for the capital markets; and is conscious that much work remains to be completed on developing a single, efficient capital market across the EU, with markets and their supporting infrastructure still significantly fractured at Member State level. All engaged in the important process of financial regulatory reform recognise the potential for the emergence of an improved financial services sector and the ICMA is striving to ensure that includes a stronger European capital market capable of performing its desired task of efficiently allocating funds to business needs. The ICMA considers that a required separation of securities trading activity would contradict the effective achievement of this highly desirable economic objective.

**Concluding statement:**

The ICMA appreciates the valuable contribution made by the European Commission through this public consultation process and would like to thank the European Commission for its careful consideration of the points made in this response, which the ICMA would be happy to review in a meeting with the European Commission team should they consider such to be helpful. The ICMA remains at your disposal to discuss any of the above points, or any further questions which may be relevant to the assessment of international capital market impacts as work progresses.

[2] Published on 8 April 2013, Economic Importance of the Corporate Bond Markets is a paper prepared by ICMA for policy makers about why corporate bond markets are so important for economic growth, for investors, for companies, and for governments, around the world; and why it is therefore essential that laws and regulations that affect them avoid any unintended adverse consequences that could inhibit those markets. The ICMA respectfully requests that this paper, which is available at http://www.icmagroup.org/assets/documents/Media/Brochures/2013/Corporate-Bond-Markets-March-2013.pdf, be carefully considered alongside of the points conveyed in this consultation response.

Yours faithfully,



David Hiscock
Senior Director - Market Practice and Regulatory Policy, ICMA

# Annex – Extract taken from the ICMA's 13 November 2012 response submission to the European Commission's consultation on recommendations of the High-level Expert Group on reforming the structure of the EU banking sector:

Separation of trading activity

The Group proposes that, in certain specified cases, proprietary trading and all assets or derivative positions incurred in the process of market-making, other than exempted activities, must be assigned to a separate legal entity; and that provision of hedging services to non-banking clients and securities underwriting are considered to be exempted activities.

Given that primary market debt origination (underwriting) and secondary market debt securities trading (market making) have been core to the ICMA's mission throughout its existence, the proposal to draw new boundaries between those entities authorised to conduct these activities is of significant interest to the ICMA.

The ICMA believes that the risks that underwriters will be taking if they are isolated from secondary market flows and information will be significantly increased. Since this separation is likely to result in lower liquidity and higher transaction costs, it must be anticipated that there will be equivalently higher fees for companies and other issuers, and hence higher funding costs.

However, the ICMA observes that it is noted in the Group's report that these activities could remain under the same holding company and that marketing could be done across the group. The ICMA wishes to highlight that, if such a separation of trading is introduced, the transfer of risk assets at fair market prices, from the underwriting entity to the secondary-market trading entity, must be allowable as already mentioned in the Group's report. Furthermore, to avoid undue risk and inefficiency there will also need to be a free-flow of secondary market knowledge from the secondary-market trading entity to the underwriting entity. Nevertheless, the ICMA is concerned that the effective realisation of such inter-entity arrangements will prove impractical to achieve. The two entities will not only have separate management and separate capital and funding constraints, but also, since risks cannot be shared due to the ring-fence, will have reduced scope for providing a holistic service to equity and bond issuers. Indeed it may be that, in terms of providing secondary market support, the economic interests of the two entities prove to be misaligned.

More broadly, however, the ICMA considers that there needs to be significant further work to determine if a recommendation for separation of trading would bring sufficient incremental benefits to justify its introduction. At the current time it is apparent that, more than ever, Europe needs a thriving and efficient capital market, able to meet the challenges of funding real economy needs whilst European economies' former dependence on funding through the channel of bank lending continues to diminish.

The ICMA is convinced that this is already a major challenge for the capital markets. Much work remains to be completed on developing a single, efficient capital market across the European Union, with markets and their supporting infrastructure still significantly fractured at Member State level. Meanwhile a huge programme of interrelated financial regulatory reform is already being put in place. This includes improvements to bank capital and liquidity (CRR/D) and to the resolvability of banks which do nevertheless run into difficulties (RRD); alongside improved rules for trading (MiFIR/D, SSR and MAR/D); and new requirements for clearing (EMIR) and settlement (CSDR). Other measures have already changed the rules for primary origination (PD) and will further improve investor protection (PRIPS), whilst the buy side of the industry must also come to terms with its new regulations (AIFMD and UCITS).

The cost of accomplishing all these changes during a relatively compressed timeframe is not just financial but also arises through uncertainty in the business environment and the distraction of management attention from ongoing business development. All engaged in this process recognise the potential for the emergence of an improved financial services sector and the ICMA is striving to ensure that includes a stronger European capital market capable of performing its desired task of efficiently allocating funds to business needs.

The ICMA believes that in a thriving and efficient capital market, primary and secondary market trading activities play symbiotic roles. A healthy flow of primary market origination helps to stimulate secondary market trading, whilst improved liquidity in secondary markets helps to underpin investor confidence and thus boost conditions for new issuers.

Separation of these activities may impede this interrelationship, thus harming overall conditions for financing, whilst at the same time not delivering dramatic improvements to safety, of the system or of investors, over and above those which should already follow from the aforementioned programme of reforms. Neither can these concerns be dealt with simply by moving both primary and secondary market trading activities out from banks, as this would create a significant stress on underwriting capacity.

The ICMA perceives that there are many more detailed points for consideration where much more work is also needed before any move to the separation of primary and secondary market trading activities should be proposed. For example, how exactly would the split be expected to work taking due account of the interrelationships found within international firms, both across business lines and across geographies? How much would such a split impact the required amounts of capital and liquidity required to finance the affected business activities, considering both the likely scale of investor demand to provide finance and the levels of return which would be expected for this? And what would be the impacts on costs from lost economies of scale, as shared knowledge, systems, facilities and management all cease to be possible?