ICMA International Capital Market Association

FICC Market Standards Board
63 St Mary Axe
London, EC3A 8AA
United Kingdom

(Submitted by email to standards@fmsb.com)

20 December 2017

Dear Sirs,

FICC Market Standards Board – Risk Management Transactions for New Issuance – standard for the Fixed Income markets (the "proposed Standard")

The International Capital Market Association (ICMA) is providing comments on the proposed Standard.

Representing a broad range of capital market interests including banks, asset managers, exchanges, central banks, law firms and other professional advisers, ICMA's market conventions and standards have been the pillars of the international debt market for almost 50 years. See: www.icmagroup.org.

ICMA's comments are given in relation to its primary market constituency that lead-manages syndicated debt securities issues throughout Europe. This constituency deliberates principally through ICMA's Primary Market Practices Committee[1], which gathers the heads and senior members of the syndicate desks of 50 ICMA member banks, and ICMA's Legal and Documentation Committee[2], which gathers the heads and senior members of the legal transaction management teams of 21 ICMA member banks, in each case active in lead-managing syndicated debt securities issues in Europe.

We set out our comments in the Annexes to this letter and would be pleased to discuss them with you at your convenience.

Yours faithfully,

C. Bellamy

Charlotte Bellamy
Director - Primary Markets
Charlotte.Bellamy@icmagroup.org
+44 20 7213 0340

[1] http://www.icmagroup.org/About-ICMA/icma-councils-and-committees/Primary-Market-Practices-Sub-committee/.
[2] http://www.icmagroup.org/About-ICMA/icma-councils-and-committees/Legal-and-Documentation-Sub-committee/.

ANNEX 1

ICMA REMARKS ON PROPOSED STANDARD

Introduction

1. ICMA welcomes the opportunity to provide comments on the proposed Standard and sets out its key comments below in order of priority.

Key concern: Core Principle 9 seems to prohibit market soundings

2. Core Principle 9 states "Prior to public announcement, information about the new issue should not be shared externally…".

3. This would appear to prohibit sounding of investors in relation to a new issue. This is concerning because sounding is a useful tool in successful new issuance and is expressly permitted under the EU Market Abuse Regulation (indeed there is specific ESMA guidance on procedures for sounding investors).

4. We suggest that Core Principle 9 is amended to address this, for example by deleting the first sentence.

Core Principle 9: ~~Prior to public announcement, information about the new issue should not be shared externally and only shared internally on a need to know basis, the policy for which should be documented.~~ Information about any RMTs should remain confidential to the transacting parties subject to complying with applicable laws and regulations, satisfying reporting requirements, and disclosing details to the extent necessary for execution, processing or settlement of that RMT.

Drafting concerns

5. Please see the drafting comments on Section III set out in Annex 2 to this letter.

6. In addition, we note that the use of defined and capitalised terms in the proposed Standard seems internally inconsistent.

Other concerns

Core Principles 1, 2 and 3 appear to relate to the new issue process generally rather than RMTs

7. The proposed Standard relates to RMTs (per its title) and is stated to apply to "all market participants who are directly involved in [RMTs] …". However, Core Principles 1, 2 and 3 appear to be relevant to the new issue process more generally, and not just when the issuer or investors are entering in to RMTs.

8. As there is already an FMSB New Issue Process Standard[3], we would suggest that consideration is given to removing Core Principles 1, 2 and 3 from the proposed Standard. If these Principles are considered to be necessary, they should be considered for inclusion in any future updated version of the FMSB New Issue Process Standard, which would seem to be the more appropriate place for them given their general nature.

[3] http://fmsb.com/wp-content/uploads/2017/04/FMSB_NewIssuesProcess_FIMarkets_2-May-FINAL.pdf

Core Principles 3, 4, 5, 7 and 8 appear to re-state existing regulation

9. Core Principles 3, 4, 5, 7 and 8 relate to activities or behaviour that is already mandated or restricted by legislation, notably MiFID (e.g. managing conflicts of interest) or MAR (e.g. prohibition on market manipulation). It is therefore not clear what purpose these Core Principles will serve. Adding new layers of guidance on top of existing, detailed regulatory regimes such as MiFID and MAR should be avoided as it may unnecessarily increase potential liability for market participants and over-complicate the new issuance process, which may impact market efficiency.

ANNEX 2

ICMA MARK-UP OF CERTAIN SECTIONS OF PROPOSED STANDARD

III Interest rate risk management activity for New Issuance

1. Issuance Process

New primary issuance of fixed income instruments ("new bond issuance" or "new issue") follows a process that is presented below at a high level. Further details of the new bond issuance process and principles that apply can be found in the New Issue Process Standard for Fixed Income Markets.

- Mandate stage
- Marketing stage
- Execution stage
- Post-launch stage

New issues are typically brought to market by a syndicate of banks (a "Syndicate"). At the execution stage the Syndicate will, on a best efforts basis, build a book of potential investors interested in purchasing the new issue~~, and such book will be~~ of a sufficient size and type in order to achieve the funding aims of the Issuer. Once the new issue has priced and the book finalised, the Issuer and the Syndicate will execute an underwriting agreement to ensure the Issuer can issue securities for the entire nominal amount and receive proceeds accordingly.

Commented [CB1]: Syndicate will aim to build a book of a sufficient size and type to achieve the funding aims of the Issuer but this is not a guaranteed outcome.

2. Rationale for risk management activity

Origination of market risk in the issuance process

The coupon and issue price for the prospective new issue are typically calculated from the Reoffer Yield (the yield at which the new issue is reoffered to Investors by the Syndicate). The Reoffer Yield is ~~calculated~~ determined as a credit spread specific to the Issuer over a Reference Rate (including but not limited to a swap rate or the yield on an asset such as a government bond or similar corporate credit, or a benchmark such as Libor).

The actual coupon and issue price for the new issue will be calculated by determining~~ed by calculating~~ the Reoffer Yield when the market observation of the Reference Rate is confirmed~~agreed~~ during the pricing call.

Issuer: Once the Issuer has decided to launch the new issue, they have the risk that a) the Reference Rate will change, and b) the spread at which they can issue relative to the Reference Rate will change, before the new issue is priced. Either of these changes will alter the pricing of the new issue.

The Issuer may decide to alter the risk profile of the issuance proceeds into a different format to suit their actual funding needs or to manage their liability profile (e.g. issues in fixed rate USD but where the Issuer requires floating rate EUR).

Investor: Once the new issue is announced and Investors have placed orders ~~decided~~ to purchase bonds, Investors in the new issue have the risk that the Reference Rate or spread to the Reference Rate will change before the issue is priced. Either of these changes will alter the pricing of the new issue.

The Investor may decide to switch out of their existing debt holdings in order to purchase the new issue (e.g. sell holdings of 12 year Issuer debt for newly issued 15 year Issuer debt), or to otherwise hedge their holding in the newly issued bond to suit their specific investment requirements.

3. Types of Risk Management Transactions

The sections below provide the most typical examples of RMTs but due to variations in the underlying transaction or the execution methods of RMTs related to new issues, this is not an exhaustive list.

Risk Management Transactions by the Issuer to hedge against movements in the Reference Rate or basis spread

In order to manage the risks associated with movements in the Reference Rate or basis spread of a new issue, Issuers may undertake RMTs to lock in a funding rate or a basis~~funding~~ spread. These transactions are typically entered into before, or around, the time that the Issuer is deciding on which Dealer to mandate for the new issue, and unwound at, or in close proximity to, the time of pricing of the new issue. The types of RMT used include:

a. **Rate Lock.** A Rate Lock may be used to provide the Issuer with a hedge against changes in the level of the Reference Rate against which the new issue is priced. This provides the Issuer with protection against a rise in the Reference Rate.

b. **Spread Lock**. A Spread Lock may be used to provide the Issuer with a hedge against the basis between an asset and swap rate, for example the spread between a government bond and swap of the same maturity. This therefore provides the Issuer with mitigation against a movement in the basis spread.

Risk Management Transactions by the Issuer to alter funding profiles

Issuers may enter into RMTs to change the liability profile of their new issue to one that conforms with their preferred funding needs. These transactions are typically entered into at, or in close proximity to, the time of pricing of the new issue. The types of RMT used include:

c. **Liability Swap**. Issuers may enter into interest rate or inflation swaps to change their future interest rate liabilities, for example, from fixed to floating. The interest rate swap may be linked to the Reference Rate of the new issue, or may be linked to a different rate but one that is related to the Reference Rate, as required by the Issuer.
d. **Cross-Currency Swaps.** Issuers may enter into cross-currency swap agreements to swap the new issuance proceeds from one currency to another, and to mitigate potential cross-currency risk arising from future cash flows, e.g. issues in fixed rate USD where floating rate EUR is required.

Risk Management Transactions by Investors

Investors often enter into RMTs at the time of pricing of a new issue, but may exercise some discretion with respect to this timing. RMTs are typically executed at spread terms agreed with the Dealer ahead of the time of trading at the pricing of the new issue. The types of strategies used include:

e. **Switches.** Investors may seek to exchange an existing holding of bonds to invest in the new issue.

f. **Hedging**. Investors may seek to simultaneously purchase the new issue with a RMT (interest rate, inflation or cross currency swap) to change the cashflows from the new issue to terms that better suit their investment requirements.

4. Conduct risks created by Risk Management Transactions

The following are the key risks associated with the use of Risk Management Transactions that the Core Principles in Section IV are intended to mitigate:

- The execution of RMTs and the management of corresponding hedging activity may influence the Reference Rate.
- The selection and formation of the Reference Rate could be conducted in a way that does not promote fair treatment to investors, issuers and other market participants.
- Material Non-Public Information ("MNPI") about new issuance, or related RMTs could be inappropriately shared with internal or external parties.

Market participants will not have complete knowledge of all the RMTs that are transacted, and the market activity that will occur, in and around the pricing window, and the corresponding effect that these could have on observable prices, including the Reference Rate. Nevertheless, market participants need to have regard to the potential impact their trading might have in and around the pricing window in the manner described in this Standard.

There are a number of scenarios that can occur based upon the types of RMTs that Issuers and Investors choose to use, and the way in which these may affect the economics of the bond issue.

The three core example scenarios are:

Scenario	Description	Example risks & conflicts of interest
Issuer does not hedge issuance	New issue comes to market and is unhedged by the Issuer. Investors may use RMTs to hedge or switch their exposure to the issue, or remain unhedged.	• The Issuer and Investor is exposed to changes in the Reference Rate. • Investor activity in the secondary cash or derivative markets could influence the Reference Rate, to which the Issuer is exposed. • The Dealer may have to manage and hedge the demand from Investors for RMTs.
Issuer hedges at point of [issuance]	Issuer may use a RMT to change its future interest rate liability. The RMT may be priced off the same Reference Rate as the Issuance or a related rate.	• Only the~~The~~ Investor is exposed to changes in the Reference Rate. • Hedging activity by the Dealer prior to the pricing call may influence the Reference Rate to which unhedged Investors are exposed. • The Dealer may have to perform hedging in a concentrated timeframe due to Issuer RMTs and demand for RMTs from Investors.

Commented [CB2]: Actually issuance typically occurs a number of days after pricing (e.g. T+5), so amend this to pricing?

Issuer hedges before the point of issuance and unwinds the hedge at the point of [issuance]	A pre-existing hedge (e.g. rate or spread lock) was used by the Issuer and is unwound at the pricing call.	• Only the~~The~~ Investor is exposed to changes in the Reference Rate. • Rebalancing of hedges by the Dealer prior to the pricing call may influence the Reference Rate to which unhedged Investors are exposed. • Dealer may have to perform hedging in a concentrated timeframe due to unwind of Issuer RMTs and the demand for RMTs from Investors.

Commented [CB3]: As above.