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ICMA

International Capital Market Association

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Foreword by Martin Scheck

Another active year in sight

The task facing ICMA as we start the New Year is every bit as challenging as it was in 2013. Along with new initiatives for 2014, there are also a number of key themes from 2013 which remain as priorities.

For example:

- We have been emphasising throughout last year the increasingly important role played by the bond markets in facilitating the free movement of capital to spur economic growth – we will continue to make the point that regulation should nurture the growth of this market rather than hinder it.
- We have become increasingly concerned during last twelve months that certain aspects of new regulation do not sit well with others, and in some cases even run counter to the overall regulatory agenda. We set out our concerns in a paper entitled *Avoiding Counterproductive Regulation in Capital Markets: a Reality Check*, which we sent to a wide range of regulators in November. Of course it is not enough simply to highlight these instances; we need to come up with constructive solutions, so we will be working with members and with public authorities to do just that in 2014.

Setting standards of best market practice is in ICMA's DNA, and our councils and committees, which cover all aspects of the

market from issuance to investment, were highly active and fully occupied in 2013. These have reviewed and improved market practices in all aspects of the cross-border markets, and they continually assess the impact of current and future regulations on the operations of the markets. We are very grateful to more than 600 individuals from our member firms who contribute to these formal committees and councils and to the many others who participate in our working groups. We remain committed to working with all market segments, public authorities, including regulators, and others to find that elusive balance which results in well regulated robust and orderly markets, with adequate investor protection which still have the capacity to perform their essential function effectively.

Broad-based representation in our committees is essential, and we broadened our reach in 2013 with formation of a further forum to complete our unique coverage of the primary debt markets – the ICMA Corporate Issuer Forum. This complements the Financial Institutions Issuer Forum which we started in 2011 and the Public Sector Issuer Forum, founded in 2012.

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We also extended our reach internationally with the establishment of a representative office in Hong Kong and the appointment of Mushtaq Kapasi as ICMA's head of Asia-Pacific. We already have many members in this increasingly important region which is experiencing rapid growth in cross-border flows. Although our representative office has only been up and running since October 2013, the physical presence is already helping with the exchange of information, and enhancing interaction with members in the region – we are leveraging our core strengths as we seek to help in the development of the Asia-Pacific debt securities markets. In this issue you will find a short article from Mushtaq talking about ICMA's focus in the region.

One of the strengths of ICMA is the ability to facilitate discussion between different groups of market participants on issues of mutual interest by bringing together representatives from our diverse committees. This has been evident in our work in the new issue market where we have put together issuers, primary syndicate managers, and investors (both retail and institutional), in various roundtable meetings in continental Europe. These meetings have been instrumental in reviewing new issue processes, identifying stresses and suggesting improvements where appropriate. This remains a focus for 2014 given the increased importance of the primary market.

In the secondary market, we expect the focus of regulatory activity on the MiFID II package to shift to detailed rule-making by the European Securities and Markets Authority. This maps well to the kind of detailed input we are able to provide from members on the ICMA Secondary Market Practices Committee and associated working groups: we expect 2014 to be tremendously active. MiFID II is just one of a range of measures we continue to deal with in the secondary markets – the

impact of the proposed CSD Regulation is another. We have also recently launched a secondary market liquidity survey, and responses from our members are due in the New Year. This will provide additional guidance as to what more we should do in respect of secondary liquidity.

Repo is an area where we continue to devote significant ICMA resource – of course to keeping the GMRA current, and providing annually updated underlying legal opinions to members, but also in assessing and responding to the range of regulatory threats to the operation of this essential component of the capital markets.

We are told that our well-timed and authoritative analysis of the impact of the proposed Financial Transaction Tax on the repo market – and hence on the ability of the entire market to function effectively – dramatically raised awareness of the impact of this ill-conceived tax. In addition, threats persist from the treatment of repo in the gross leverage ratio and from the shadow banking proposals and we will continue to work hard on this in 2014 with a particular focus on the cross-cutting theme of collateral.

There are many other topics we will focus on in 2014. The following selection gives some idea of their scope and breadth, and we very much encourage member participation: an extensive programme through our Asset Management and Investors Council; assessing the implications of the European Banking Union on the securities markets; completing our work on a revised model collective action clause for non-EU countries; finalising and encouraging use of the *Guide to Best Practice in the International Repo Markets*; finalising the review of the ICMA Primary Market Handbook; as well as an initiative on "green bonds" and the role of the securities market in financing infrastructure. Further details are available on our website or directly from the

relevant members of ICMA staff.

Our membership continues to grow (we now have 457 members in 54 countries) and our services have expanded to match. For example in mid-2013 we extended the Legal Helpdesk to cover both legal and regulatory topics and since then have received many hundreds of calls from members on the helpline. Our conferences, seminars and roundtables, along with our executive education courses have been greatly in demand and ran at record levels in 2013. There is increasing interest in these and so I am sure that in 2014 we will see further growth.

As a concluding remark, at this time last year I spoke about the need for the restoration of trust in the industry. One year on and the industry is not really much further forward in this respect, as a cursory glance at the daily papers will confirm. Much of ICMA's work – providing education and training for market practitioners, setting standards of best practice, providing standardised documentation, putting predictability into process and procedures, the ICMA Wealth Management Charter of Quality etc – contributes to the restoration of trust. This is a long-term process where much is yet to be done – and it remains a continuing priority for ICMA.

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European Banking Union and capital markets

Quarterly Assessment by Paul Richards

Summary

The first step towards European Banking Union in the euro area is the establishment of the Single Supervisory Mechanism, which is due to be operational in November 2014. It will be preceded by the ECB's assessment of euro-area banks through the proposed Asset Quality Review and stress test. If the ECB's assessment is not tough enough, it will not be credible in capital markets. But if it is too tough, there is a risk that some national governments in the euro area will not be able to recapitalise their national banks without undermining their own public finances, which would also damage market confidence. In the case of the US, the stress test undertaken in 2009 in response to the international financial crisis *did* help to restore confidence in US banks. In Europe, by contrast, there were doubts in capital markets about the effectiveness of the EBA's stress tests between 2009 and 2011. This makes it all the more important that the ECB's assessment over the next year is regarded in capital markets as credible, so that the outcome reduces market uncertainty about the resilience of the banking system, and helps to encourage – rather than damage – economic recovery in Europe. One remaining issue which therefore needs to be fully resolved is the establishment of a credible public backstop for banks in the euro area through the proposed Single Resolution Mechanism.

Introduction

1 European Banking Union in the euro area has three main potential elements:

- the Single Supervisory Mechanism (SSM), which has been agreed and is due to be implemented in November 2014;
- the Single Resolution Mechanism (SRM), on which political agreement has been reached by the Council of Ministers, but with important issues still to be resolved, including negotiations with the European Parliament; and
- euro-area deposit guarantees, on which agreement is limited to a national network.

This Quarterly Assessment, which covers the period until the end of 2013, considers these three different elements and their potential impact on international capital markets.

The Single Supervisory Mechanism

2 Under the SSM Regulation, the ECB is due to take overall responsibility for the supervision of the banks in the euro area, and in other EU countries which opt in, from November 2014: the ECB is due to take direct responsibility in the case of around 130 of the largest banks; and the ECB is due to coordinate national supervisors in the case of other banks. (There are over 6,000 banks in the euro area as a whole.) Before taking over responsibility, the ECB announced on 23 October 2013 that it would undertake a "comprehensive assessment" of around 130 of the largest banks, which represent 85% of the assets of banks in countries participating in the SSM.

The assessment started in November 2013 and is due to take 12 months. It is being undertaken by the ECB in cooperation with national supervisors.

3 In undertaking the assessment, the ECB has three main aims:

- to foster transparency by enhancing the quality of information available about the condition of the banks;
- to repair bank balance sheets by taking corrective action where needed; and
- to rebuild confidence by assuring stakeholders that banks are fundamentally sound and trustworthy.

4 There are three related elements in the assessment:

- a *supervisory risk assessment* to review – quantitatively and qualitatively – key bank risks, including liquidity, leverage and funding;
- an *asset quality review* (AQR) to enhance the transparency of bank exposures by reviewing the quality of banks' assessments, including the adequacy of asset and collateral valuation and related provisions for sovereigns, institutions (including interbank), corporate and retail exposures, covering both the banking book and the trading book, on and off-balance sheet; and
- a *stress test* to examine the resilience of banks' balance sheets to stress scenarios. Details are to be announced in due course. The stress test is to be conducted by the ECB in conjunction with the European Banking Authority (EBA), as the EBA has a mandate to conduct stress tests for banks across the EU as a whole (which it previously undertook between 2009 and 2011).

5 The ECB's assessment will be based on a capital benchmark of 8% Common Equity Tier 1, calculated as a ratio to risk-weighted assets, and based on CRD

IV/CRR, for both the AQR and the stress test. This threshold can be broken down into a Common Equity Tier 1 ratio of 4.5% and a 2.5% capital conservation buffer, with an extra 1% to take into account the systemic significance of the banks reviewed. Use of a leverage ratio is designed to provide additional information for assessing outcomes.

6 The ECB estimates that, since the beginning of the crisis, euro-area banks have raised €225 billion of fresh capital, and a further €275 billion has been injected by governments (ie the equivalent of over 5% of euro-area GDP). As a result, the median Core Tier 1 capital ratio of the largest euro-area banks is close to 12%, and most of them already comply with the minimum regulatory capital requirements of CRD IV/CRR when fully implemented.

7 The outcome of the ECB's assessment is due to be disclosed at national and bank level, together with any recommendations for supervisory measures, in October 2014: ie shortly before the ECB takes over its supervisory role in November 2014. It may include requirements for changes in a bank's provisions and capital. Where necessary, the ECB will encourage enhanced disclosure and provisioning, recapitalisation, asset separation and asset sales, and other corrective measures, *before* the conclusion of the exercise.

8 When the EBA conducted stress tests of banks across the EU between 2009 and 2011, there were doubts in the market about their effectiveness: for example, a few individual banks cleared by the tests ran into trouble shortly afterwards. By contrast, the stress test undertaken in the US in 2009 proved effective in restoring trust in US banks and market confidence in response to the international financial crisis. In order to help restore trust and confidence in banks in the euro area, it is important for the ECB's assessment of banks in 2014 to be credible.



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9 As the ECB has not previously had responsibility for banking supervision, it will first of all need sufficient qualified staff to undertake the assessment. (The task for the ECB in assessing around 130 of the largest banks in the euro area compares with 19 institutions when the Federal Reserve undertook the stress test in the US in 2009.) It has been announced that Danièle Nouy, previously Secretary General of the *Autorité de Contrôle Prudentiel et de Résolution*, will be the head of the new ECB Supervisory Board. Initially, around 800 staff are being recruited by – or seconded to – the ECB, mainly from national supervisors, and there will be consultancy support (from Oliver Wyman). In assessing banks based in each national jurisdiction, staff from the ECB and from supervisors in other national jurisdictions will be involved to help ensure a common approach across borders.

10 Second, the supervisory role of the ECB in assessing the banks, on the one side, will need to be kept separate from the monetary policy role of the ECB in providing liquidity to the banks, on the other side. However, it is important to note that separation between monetary policy and bank supervision is already managed by many other central banks. And separation is not intended to be complete. There are some potential links: eg flows of information between the monetary policy and bank supervisory sides. And if the ECB were to conclude that bank deleveraging – in particular on the periphery of the euro area – to meet its capital benchmark, on the supervisory side, was harming the recovery in the real economy, the ECB could if necessary provide more liquidity to banks in the euro area. It has been suggested that this might be made conditional on its use to lend to the real economy, though that would be difficult to define.

11 Third, when the ECB undertakes the assessment, it is not just high standards of bank disclosure (eg to reduce market uncertainty about bank exposure to different risks) that will be important, but also consistency of treatment across different national jurisdictions: eg common valuation procedures across borders; common rules for the treatment of non-performing loans; and standard definitions of default. In particular, sovereign debt has traditionally been treated as risk-free for capital purposes; but, in response to the crisis, there is now a question about how much capital banks should be required to hold against any sovereign debt no longer regarded as risk-free. (The average S&P sovereign rating in the euro area has fallen from AA+

before the crisis to single A now.) The proposed stress test is likely to be of particular importance for banks in countries (eg Italy and Spain) where the proportion of national debt of sovereigns in the euro area held by their national banks has increased substantially since the start of the crisis, so that it now represents around two-thirds on average across the euro area as a whole. By contrast, the euro-area authorities want to break the interdependent link between sovereign debtors and their national banks, which is widely regarded as one of the contributors to the crisis.

12 Fourth, the SSM gives the ECB power to withdraw the licence of a bank, but not to recapitalise it. So if the AQR and stress test show that a bank has a capital shortfall, the shortfall will need to be filled in some other way. It is not yet clear whether the ECB may initially try to resolve this problem by giving a bank that needs it more time to comply. If not, the bank may attempt to meet the capital benchmark by deleveraging its balance sheet. If more capital is still needed, the next step is for the bank to raise capital in the market, but this may be difficult if the market concludes that the bank has failed the stress test. In the case of a bank with insufficient capital, there is a question to be resolved about whether debt holders will be bailed in first, under EU competition rules for state aids, before taxpayers are called on to recapitalise the bank, even if the bank is not in default.

13 Fifth, if a bank were to fail in future and needed to be resolved (ie wound up), there is agreement, under the EU Bank Recovery and Resolution Directive (BRRD), that the cost of failure should be borne by investors and creditors rather than by taxpayers; and that there needs to be a hierarchy of stakeholders to be bailed in. The bail-in hierarchy proposed in the EU starts with equity investors, then junior debt holders, then senior debt holders and finally uninsured depositors. Uninsured deposits from large companies are to be bailed in before depositors from small companies and individuals. Insured depositors (up to €100k in the EU) are guaranteed not to be bailed in. The BRRD is due to apply across the EU from the beginning of 2015, with the bail-in system applying from the beginning of 2016.

14 However, in case private sector funds are insufficient, a credible public backstop is widely regarded as critical to the effectiveness of the SSM.

The Single Resolution Mechanism

15 So the second element in European Banking Union is the proposed Single Resolution Mechanism (SRM), which is designed to act as a public backstop for banks in the euro area. The question is what form the public backstop should take. There have been two different approaches to the question of how the SRM should be organised and financed.

16 One approach, originally taken by the German authorities, was that the SRM should be introduced in two steps, the first step of which would consist of a resolution mechanism based on a network of national authorities rather than a Single Resolution Fund.

17 The other approach, taken by the European Commission, was to propose (on 10 July 2013) a Regulation to create the SRM, under which the decision to trigger resolution would be taken by the Commission, and which would consist of:

- *a Single Resolution Board:* to prepare and implement resolution of any bank participating in the SSM, when necessary: by selling or transferring critical functions; by creating a bridge bank; by separating “good” from “bad” bank assets; or through “bail-in” by writing down liabilities. Bail-in would exclude insured deposits (up to €100k). Otherwise bail-in would follow the agreed hierarchy of claims on a bank, with deposits (above €100k) being bailed in last; and
- *a Single Resolution Fund:* to provide medium-term funding to support this. The target level of funding for the Single Resolution Fund proposed by the Commission was €55 billion, though it was recognised that the target would take time to achieve. It would be financed *ex ante* and *ex post* by bank contributions – from all institutions covered by the SRM – rather than by taxpayers. The Single Resolution Fund would be used to absorb losses by injecting capital or purchasing shares: if at least 8% of liabilities were bailed in; and contributing up to 5% of a bank’s liabilities. If that proved to be insufficient, the Single Resolution Fund would be able to borrow from other sources, financed through *ex post* levies on the banks.

18 The key questions relating to the SRM which have proved difficult to resolve include:

- how the decision-making process for resolving a failing bank would work: the ECB in particular has

argued that decisions would need to be made quickly (eg over a weekend);

- whether resources should be pooled to create a single euro-area backstop so that it could be used to bail out banks anywhere in the euro area, or whether national resolution funds should first be used to bail out national banks, and the use of the pooled euro-area backstop should be subject to conditions which provide strict national budgetary safeguards: the Commission and the ECB have argued that, without a euro-area SRM, the euro-area SSM would be much less likely to be effective; and
- whether a Single Resolution Fund of €55 billion would be large enough; if not, whether there would need to be a further backstop, and if so who would provide it and how it would be funded: in particular, whether it would be funded by the banks or by the European Stability Mechanism, which is funded by taxpayers and includes €60 billion potentially available directly to recapitalise banks, but has so far been used only to bail out governments.

19 These issues need to be resolved both credibly and in good time before the SSM becomes operational. On 18 December 2013, the ECOFIN Council agreed a compromise, subject to negotiation with the European Parliament before May 2014, under which the SRM would enter into force on 1 January 2015, and bail-in and resolution functions would apply from 1 January 2016, under Article 114 of the EU Treaty. The SRM would apply throughout the euro area, and to other EU Member States deciding to opt in. And it would cover all banks directly supervised by the ECB, with national resolution authorities responsible for all other banks.

20 Under the proposed SRM Regulation, either the ECB would notify the Single Resolution Board if a bank was failing or likely to fail, or on its own initiative, the Board would adopt a resolution scheme placing the bank into resolution. Decisions by the Board would enter into force within 24 hours after their adoption, unless the Council, acting by a simple majority on a proposal by the Commission, objected or called for changes. The Board would consist of an executive director, four full-time appointed members and the representatives of the national resolution authorities in all participating countries. Most decisions would be taken by the executive members



There are a number of important issues relating to the SRM, and in particular relating to the creation of a credible public backstop, which remain to be fully resolved.

of the Board, but all decisions requiring access to the Single Resolution Fund once a total of €5 billion had been used in a given year, and some other decisions, would need to be agreed by a two-thirds majority of all Board members representing at least 50% of contributions. A simple majority of the Board could also oppose decisions by the executive to borrow. And the draft SRM Regulation would prohibit decisions requiring a Member State to provide extraordinary public support without its prior approval under national budgetary procedures.

21 A commitment was also made on 18 December 2013 by euro-area Member States to negotiate, by 1 March 2014, an inter-governmental agreement on the Single Resolution Fund, under which national contributions to the Fund would progressively be mutualised over a ten-year transitional phase, financed by bank levies; and a backstop to the Single Resolution Fund during the transitional phase would be established, with bridge financing from national sources, backed by bank levies, *ex ante* and if necessary *ex post*, or from the European Stability Mechanism. The proposed inter-governmental agreement among Member States participating in the SSM/SRM would enter into force once ratified by Member States representing 80% of contributions to the Single Resolution Fund. The SRM Regulation would be conditional on the entry into force of the inter-governmental agreement.

22 Consequently, there are a number of important issues relating to the SRM, and in particular relating to the creation of a credible public backstop, which remain to be fully resolved.

Euro-area deposit guarantees

23 The third element in European Banking Union is the provision of euro-area deposit guarantees. Under the Deposit Guarantee Schemes Directive, on which political agreement was reached between the Lithuanian Presidency and the European Parliament on 17 December 2013, the level of deposit guarantees throughout the EU is set at national level and harmonised at €100k; in the event that a bank fails, the guarantees are underwritten by other banks or if necessary by taxpayers at national level, not at euro-area or EU level. There is no agreement at present on supporting insured deposits in one euro-area country (eg Spain) with guarantees from banks

in another country (eg Germany) through a single euro-area deposit scheme.

Other related issues

24 The outcome on European Banking Union may well affect the economic recovery in Europe. If the outcome is credible, it should help to rebuild confidence in international capital markets by reducing market uncertainty about the resilience of the euro-area banking system and by reducing national fragmentation within the euro area. But if not, it risks damaging confidence.

25 Apart from the three main elements involved, there are several other related issues that need to be considered:

26 First of all, the proposals on European Banking Union relate to the euro area rather than the EU as a whole. In some cases (eg the SSM), EU countries which have not joined Monetary Union by participating in the euro can opt in to the SSM. The UK, Sweden and the Czech Republic have so far opted not to do so.

27 Second, European Banking Union depends on the implementation of a common regulatory rulebook: for banks (through the EBA); for firms engaged in the securities markets (ESMA); and for insurers and providers of occupational pensions (through EIOPA). There is still a considerable way to go to achieve this.

28 Third, the risk of continuing national fragmentation in capital markets could be reduced through cross-border mergers between banks, which would create more banks with operations across the euro area as a whole and reduce dependence on national banks. But new EU regulations, which require large and complex banks with systemic significance to provide proportionately more capital than smaller ones, act as a disincentive. Regulators also appear to have been encouraging banks which operate across borders to set up separate national subsidiaries rather than branches.

29 Fourth, even if and when European Banking Union is achieved, there will still not be a Fiscal Union in the euro area. Steps have been taken to coordinate fiscal policies in different euro-area countries, and to ask national authorities to seek prior approval for their national budgets from the European Commission. But

there is no central control in the euro area over national budgets nor national budget deficits, and government debt is issued at national level, not euro-area level. Euro-area control of budget deficits and pooling of euro-area sovereign debt would require an EU Treaty change.

30 Finally, the focus here has been on the EU and within the EU on the euro area. But the relationship between the EU and third countries – eg the US and countries in Asia – is increasingly important for economic prosperity in the EU, including the euro area.

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The outcome on European Banking Union may well affect the economic recovery in Europe.

Practical initiatives by ICMA

The purpose of the following list is to summarise practical initiatives on which ICMA is currently, or has recently been, engaged with, and on behalf of, members.¹

Short-term markets

- 1 *GMRA Protocol:* ICMA has announced the adherence of three parties to the 2011 GMRA Protocol (Revised). The Protocol enables parties to amend certain terms of their existing GMRA documentation to reflect certain provisions of the GMRA 2011 and to insert a definition of euro, on a multilateral basis.
- 2 *Guide to repo best practice:* ICMA is due shortly to publish a *Guide to Best Practice in the International Repo Market*. This consolidates and updates ICMA's existing repo trading practice guidelines and various other published statements.
- 3 *Financial Transaction Tax (FTT):* Following the publication of ICMA reports on the impact of the FTT on the repo market and on the systemic importance of collateral, ICMA has continued to explain to the authorities why the original proposal could seriously impair markets and is continuing its efforts to draw attention to the need for changes, not just to exempt repo transactions, but across debt capital markets generally. ICMA has also supported the publication of a recent FTT literature review, carried out by PwC.
- 4 *Leverage ratio:* Following its response to the consultation by the Basel Committee on Banking Supervision on the revised Basel III leverage ratio, the ICMA European Repo Council (ERC) has actively been articulating its concerns about the negative impact on the function of the repo market, if the proposal is not revised.
- 5 *Shadow banking:* Jointly with ISLA, the ICMA ERC has responded to the Financial Stability Board's consultation on *Strengthening Oversight and Regulation of Shadow Banking*; and has also taken the opportunity to publish some further thoughts on the final recommendations on securities lending and repos which the FSB published at the end of August.
- 6 *Russian repo:* For the benefit of international market participants, ICMA, together with ISDA and NAUFOR, supported an event hosted by the EBRD in London on Russian repository reporting and close-out netting. ICMA also recently held a number of meetings in Moscow and played an important part in support of the NSMA's IX (annual) International Repo Forum, *Financial Market 2014: Regulation, Liquidity, Instruments*, which was also supported by the Bank of Russia and other local entities.

- 7 *Repo survey:* For the purposes of ICMA's 26th European repo market survey, results of which should be available in January 2014, all European repo market participants are invited to submit data on their repo business outstanding at close of business on Wednesday, 11 December 2013.

Primary markets

- 8 *Public Sector Issuer Forum (PSIF):* A further meeting of the PSIF was held at the World Bank in Washington in October, at which PSIF members had an exchange of views with the Federal Reserve Bank of New York.
- 9 *Prospectus Directive, PRIPs and Market Abuse Regulation:* In implementing these new and revised regimes, ICMA is continuing to work with members in its primary market committees and related working groups to obtain clarity from regulators about how they should be interpreted or applied.
- 10 *LIBOR, Italian new issue reporting requirements and retail structured products:* ICMA has contributed responses to five consultations in these three areas.
- 11 *ICMA Primary Market Handbook:* ICMA has published revised ICMA Recommendation 1.31, *Joint Leads Without Responsibility for the Order Book*. The general review of ICMA's Primary Market Handbook is continuing.
- 12 *Collective action clause (CAC):* With help from Clifford Chance, ICMA has updated the CAC in the ICMA Primary Market Handbook, focusing on its potential use outside the euro area, and has published a consultation on its website.
- 13 *New issue processes:* ICMA has organised roundtables gathering some issuers, lead managers and investors in both Frankfurt and Zurich, as well as a meeting of syndicate managers in Hong Kong.
- 14 *Primary Market Forum:* ICMA hosted its seventh annual Primary Market Forum at Freshfields on 13 November.

Secondary markets

- 15 *MiFID II package:* ICMA is working with other trade associations on assessing forthcoming Level 2 measures relating to the MiFID II package.
- 16 *Electronic trading group:* ICMA organised a roundtable on 29 November to establish an electronic trading working group. The group has agreed terms of reference, and discussed the forthcoming agenda for 2014, looking at a range of practical issues in the institutional bond markets.
- 17 *Liquidity survey:* ICMA's work on secondary market liquidity is intended to engage with regulatory reform, seeking to ensure that the regulations now

being enacted should achieve their policy goals without causing unnecessary frictional cost or adverse consequences to the functioning of the market. The output could be used to inform the debate about trading fragmentation and transparency in Europe and should also provide general "colour" about the state of the market as a whole.

Asset management

- 18 *AMIC Council:* The AMIC Council met on 20 November in London. Panellists discussed some key issues and trends for the asset management industry, such as quantitative easing by central banks and restoring trust and the reputation of the asset management industry.
- 19 *Covered bonds:* The ICMA Covered Bond Investor Council set out its position on treating covered bonds as Level 1 assets in LCRs.
- 20 *Governance research:* The AMIC responded to the consultation on the *Best Practice Principles for Governance Research Providers*, supporting this initiative as long as it creates more transparency on issues such as conflicts of interest.

Other initiatives

- 21 *Avoiding counterproductive regulation:* In response to widespread concerns that the cumulative impact of current and proposed regulatory reform threatens to undermine core aspects of the economic functions of trading in the European repo and fixed income markets, ICMA has produced a paper entitled *Avoiding Counterproductive Regulation in Capital Markets: A Reality Check*. ICMA sees this paper as a first step in a process of open-ended engagement with policy makers, to whom it has been sent, with a view to addressing the concerns expressed. Follow-up steps, focusing on the important underlying question of collateral, are under way.
- 22 *ESMA's Stakeholders Group:* ICMA's President, René Karsenti, has been appointed a member of the ESMA Stakeholders Group.
- 23 *Central banks and regulators:* With the chairs and senior representatives of its Market Practice and Regulatory Policy Committees, ICMA continues to hold regular meetings with senior representatives of central banks and regulators.
- 24 *Regulatory grid:* A further updated version of ICMA's grid of new financial regulations affecting the cross-border securities markets has been posted on a password-protected section of the ICMA website for ICMA members.

1. ICMA responses to consultations by regulators are available on the ICMA website.

Regulatory Response to the Crisis



by David Hiscott

G20 financial regulatory reforms *Economic growth*

A [communiqué was issued](#) following the meeting of Finance Ministers and Central Bank Governors, held in Washington, on 10-11 October 2013. Noteworthy paragraphs within this include:

- “3. We reaffirm the importance of long-term financing for investment to boost growth, create jobs and facilitate development and are moving forward with the work plan endorsed in St Petersburg, including further work on private sector investment flows. We will identify measures to facilitate domestic capital market development and improve the intermediation of global savings for investments and work on approaches to implement the G20/OECD *High-Level Principles of Long-Term Investment Financing by Institutional Investors*. We take note of the work underway in the World Bank Group and Regional Development Banks to mobilize and catalyse additional financing for infrastructure investment, particularly in emerging market and developing countries.”
- “5. We welcome the ongoing work by International Organizations to support

the improvement of debt management practices in light of recent experiences. Having contributed to the progress of reviewing and updating the *Guidelines for Public Debt Management*, we look forward to the completion of this work by the IMF and the World Bank Group in early 2014.”

- “7. We will pursue our work to build a safe and reliable financial system by implementing the financial reforms endorsed in our Leaders’ Declaration, which are aimed at building upon the significant progress already achieved, including in creating more resilient financial institutions, ending “too big to fail”, increasing transparency and market integrity, filling regulatory gaps, addressing the potential systemic risks from shadow banking and closing information gaps.”

This meeting took place in the context of the [Annual Meetings](#) of the World Bank Group and the IMF. Amongst other meetings which also took place, there is a [communiqué which reports](#) on the Twenty-Eighth Meeting of the International Monetary and Financial Committee (IMFC). The IMFC is responsible for advising and reporting to the IMF Board of Governors as it manages and shapes the international monetary and

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We will identify measures to facilitate domestic capital market development and improve the intermediation of global savings for investments.

financial system. The IMFC also monitors developments in global liquidity and the transfer of resources to developing countries; considers proposals by the IMF Executive Board to amend the Articles of Agreement; and deals with unfolding events that may disrupt the global monetary and financial system. Documents related to this meeting, and copies of statements given, are also available.

Capital requirements

On 31 October 2013, the Basel Committee for Banking Supervision (BCBS) issued a [second consultative paper](#) (for comment by 31 January 2014) on the fundamental review of capital requirements for the trading book. The paper comprises a detailed set of proposals for a comprehensive revision of the market risk framework. This initiative forms part of the BCBS's broader agenda to reform regulatory standards for banks in response to the financial crisis. The [May 2012 consultative paper](#) set out a number of specific measures to improve trading book capital requirements. These initial proposals reflected the BCBS's overall objective of designing a new regulatory framework that addresses weaknesses in risk measurement under the current internal models-based and standardised approaches, with a view to promoting consistent implementation across jurisdictions. This second consultative

document provides more detail on the approaches introduced in May 2012, and sets out a draft text for a revised market risk framework. It has been informed by comments received on the first consultative paper, and lessons learnt from the BCBS's recent investigations into the variability of market risk-weighted assets. On 17 December 2013, the BCBS published its second report on the *Regulatory Consistency of Risk-Weighted Assets* (RWAs) for market risk in the trading book. This study is a part of the BCBS's wider *Regulatory Consistency Assessment Programme* (RCAP), which is intended to ensure consistent implementation of the Basel III framework.

Resilience of the financial system

At its [meeting in Moscow on 8 November](#), the Financial Stability Board (FSB) discussed vulnerabilities affecting the global financial system and reviewed work plans for completing core financial reforms in 2014. Points related to the latter include:

- *Building resilient financial institutions:* Members discussed the BCBS's schedule for completing the remaining pieces of policy work on Basel III, including the leverage ratio and the NSFR, as well as the BCBS's work to address excessive variation in banks' risk weighting of assets.

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- *Ending “too big to fail”:* Members discussed the key near-term deliverables in the ongoing work to address SIFIs, as set out in the FSB’s [report to the St Petersburg Summit](#). The FSB:
 - reviewed the priorities in the work on resolution of financial institutions, including for the development in 2014 of proposals on gone-concern loss absorbing capacity for G-SIFIs and a framework for the cross-border recognition of resolution actions;
 - approved the [annual update of the list of G-SIBs](#), using the updated assessment methodology published by the BCBS in July;
 - reviewed guidance drawn up to assist supervisors in their assessment of financial institutions’ risk culture;
 - agreed to work with the IMF and World Bank to develop a work plan to examine the root causes behind the results in the IMF-World Bank FSAP relating to supervisory independence and resources, in order to remove obstacles to supervisory effectiveness;
 - reviewed and welcomed the work plans of the International Association of Insurance Supervisors (IAIS) for the development of (i) a backstop capital requirement on which higher loss absorbency for G-SIIs will be built, and (ii) a comprehensive, group-wide supervisory and regulatory framework for internationally active insurance groups, including a quantitative capital standard; and
 - discussed an initial draft of proposed assessment methodologies for identifying non-G-SIB/non-G-SII global SIFIs, prepared in consultation with IOSCO.
 - *Shadow banking:* The FSB reviewed and approved the 2013 *Global Shadow Banking Monitoring Report*, which

was published on 14 November. In August the FSB published a set of policy recommendations to strengthen oversight and regulation of shadow banking and members discussed the work plan for 2014-15 for implementing those policies, consistent with the roadmap; and a review of possible impediments to resumption of sound securitisation markets.

- *Making derivatives markets safer:* Members received an update on the remaining areas where international policies are still being developed, including the finalisation of standards for capitalisation of bank exposures to CCPs by early 2014, and of international guidance on the recovery and resolution of FMs, including CCPs, by end-2013. The FSB stressed the need for progress in the implementation of reforms and by regulators in resolving remaining cross-border regulatory issues.
- *Accounting and auditing:* The FSB heard updates from the Chairs of the IASB and the US FASB on their continuing work to improve and converge accounting standards, including two key areas for financial stability: loan loss provisioning and insurance contracts. The FSB also discussed the International Valuation Standards Council’s proposals to develop valuation standards for financial instruments that could help to augment the valuation rules within accounting standards.

Shadow banking

On 14 November, the FSB published its third annual [Global Shadow Banking Monitoring Report](#). The report includes data from 25 jurisdictions and the euro area as a whole; these jurisdictions represent about 80% of global GDP and 90% of global financial system assets. For the first time the report also

incorporates estimates from a hedge fund survey by IOSCO. The exercise was conducted by the FSB Analytical Group on Vulnerabilities (AGV), the technical working group of the FSB Standing Committee on Assessment of Vulnerabilities (SCAV), using quantitative and qualitative information, and followed a similar methodology to that used for the [2012 report](#). Its primary focus is on a “macro-mapping”, based on national Flow of Funds and Sector Balance Sheet data, that looks at all non-bank financial intermediation to ensure that data gathering and surveillance cover the areas where shadow banking-related risks to the financial system might potentially arise. Going forward, the FSB’s monitoring will benefit from further improvement and follow-up by jurisdictions to address identified gaps and data inconsistencies. Improvements in data availability and granularity are necessary for authorities to be able adequately to capture the magnitude and nature of risks in the shadow banking system.

Risk management

On 18 November 2013, the FSB [published two papers](#) to assist supervisors in strengthening risk management practices at financial institutions: (i) *Principles for an Effective Risk Appetite Framework*; and (ii) *Guidance on Supervisory Interaction with Financial Institutions on Risk Culture*. These papers form part of the FSB’s initiative to increase the intensity and effectiveness of supervision, which is a key component of the policy measures to address SIFIs that were endorsed by the G20 in November 2010 to address the problem of firms that are “too big to fail”. Supervisory expectations for firms’ risk management functions and overall risk governance frameworks are increasing, as these were areas that exhibited significant weaknesses in many financial institutions during the global financial

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crisis. *The Principles for an Effective Risk Management Framework* were issued for public consultation in July 2013 and have been revised in light of the comments received during that consultation. Respondents generally supported the overall direction of the draft *Principles*, but sought more clarity on the extent to which a financial institution's risk appetite should be cascaded to individual legal entities and business units. The responses to the public consultation are available on the FSB's website. The level of risk appetite that a financial institution sets will be influenced by its risk culture, in other words the institution's attitude toward and acceptance of risk. The FSB has therefore issued for public consultation (comments by 31 January 2014) a Guidance Paper to assist supervisors in assessing the risk culture at financial institutions.

Market structure

On 13 December 2013, IOSCO [published its final report](#) on *Regulatory Issues Raised by Changes in Market Structure*, which makes four recommendations that seek to promote market liquidity and efficiency, price transparency, and investors' execution quality in a fragmented environment. Focusing on equities and ETFs, the report identifies possible outstanding issues and risks posed by existing or developing market structures and it describes how these risks should be addressed. Finally, it recommends that regulators monitor the impact of fragmentation on market quality. Previous analyses and recommendations by IOSCO in other related areas have been taken into account in this report. Specific reference is made to the 2011 report on *Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency* and the 2013 report on *Technological Challenges to Effective Market Surveillance Issues and Regulatory Tools*. The report also updates the 2001 IOSCO report on *Transparency*

and Market Fragmentation, to the extent that it provides an overview of the current state of market fragmentation and regulatory steps taken in various members' jurisdictions since 2001. In this period, the market structure of most jurisdictions surveyed has evolved from a single (or few) trading space within the same jurisdiction to multiple trading spaces for the same financial instrument. This final report outlines the current state of play in market structures in most IOSCO jurisdictions, affirms the main findings and challenges identified through the 2012 survey and the 2013 public consultation. And it adopts as final the recommendations set forth in the March consultation report, and recommends that regulators should monitor the impact of fragmentation on market integrity and efficiency; availability and timeliness of information; order handling rules and best execution; and access to liquidity.

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European financial regulatory reforms

ESMA's 2014 Work Programme

ESMA has [published its 2014 Work Programme](#) which sets out its planned activities for 2014. This is an extension of ESMA's High-Level Work Programme submitted to the European Commission as part of the budget request for 2014 and as such assumes that the budget request of the Board of Supervisors to the European Commission is approved by the EU institutions. This budget is for €32.5 million and a staff base of 195 people. In the work programme ESMA's activities and priorities are grouped under its five objectives:

- Convergence: corporate reporting; peer reviews, breach of union law and mediation; training; Joint Committee;



Reporting of asset encumbrance will be implemented on 30 June 2014 by large institutions with assets above €30 billion.

and international co-operation (17 detailed tasks);

- *Financial consumer protection:* product intervention; co-ordinated regulatory approach; and Packaged Retail Investment Products (11 detailed tasks);
- *Financial stability:* financial market surveillance; and economic research (8 detailed tasks);
- *Single Rulebook:* revision of MiFID and MAD; European Investment Fund legislation; corporate finance; CRA Regulation; and CSD Regulation (33 detailed tasks);
- *Supervision:* Credit Rating Agencies; post-trading; and enforcement and independent investigation (11 detailed tasks).

Annex 4 of the Work Programme enumerates 118 detailed tasks, of which 80 relate to the above activities and priorities, whilst the other 38 relate to operational set-up. A more detailed regulatory work programme will be adopted by the Board of Supervisors in the first quarter of 2014. In addition, the EBA has also published its Work Programme for 2014; and the Joint Committee of the ESAs has also published one.

European Commission's 2014 Work Programme

As announced on 22 October 2013, the Commission has adopted its [Work Programme for 2014](#). The Commission has put a very strong focus on results, designating 2014 as "a year of delivery and implementation". For the first time, the Commission Work Programme includes a list of already-adopted legislative proposals which the Commission believes deserve special attention, given their importance and given that they are sufficiently advanced to have a realistic chance of adoption in the coming months. These issues (Annex 1 of the Work Programme) give a clear indication of the areas where the Commission will invest its attention in the six months before the European Parliament elections. With respect to financial services, these issues include:

- Single Resolution Mechanism;
- Framework for Bank Recovery and Resolution;
- Deposit Guarantee Schemes;
- Markets in Financial Services Directive (MiFID);
- Long-term investment funds; and
- Financial Transaction Tax.

There are a limited number of new initiatives, the two for financial services being follow-up to the Green Paper on *Long-Term Financing of the EU Economy*; and the framework for crisis management and resolution for financial institutions other than banks.

EBA technical standards

On 22 October 2013, the EBA launched [three consultations](#), for comment by 22 December 2013, on draft technical standards (ITS and RTS) related to liquidity requirements. In particular, the EBA consulted on: (i) draft ITS on currencies for which the justified demand for liquid assets exceeds their availability; (ii) draft RTS on derogations for eligible currencies; and (iii) draft ITS listing the currencies with an extremely narrow definition of central bank eligibility. A public hearing for the three consultations took place at EBA's premises on 19 November. The proposed draft ITS and RTS have been developed on the basis of the EU CRR. Having taken into appropriate account the feedback gathered through the consultation process, the EBA is expected to submit these draft ITS and RTS by 31 March 2014.

On 30 October 2013, the EBA published its final ITS on [reporting for asset encumbrance](#). These ITS, which will be part of the EU Single Rulebook in banking, provide reporting templates and instructions with the ultimate aim of ensuring harmonised reporting of asset encumbrance across institutions. The final standards have been sent to the European Commission for their adoption as EU Regulations that will be directly applicable throughout the EU. The reporting of asset encumbrance will be implemented on 30 June 2014 by large institutions with assets above €30 billion and on 31 December 2014 by all other institutions. The next step will be the development of a set of guidelines on asset encumbrance disclosure that will provide clear and consistent standards in this area. The EBA expects to publish a consultation paper on these guidelines in coming months. The final version will then be published in June 2014 and reviewed after one year. This review will then form the basis for the binding technical standards on more extensive disclosure that the EBA will have to develop by 2016.

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EBA reports on liquidity

On 20 December 2013, the EBA [published two reports on liquidity](#), namely (i) on the impact assessment for the liquidity coverage requirement (LCR) and (ii) on appropriate uniform definitions of extremely high quality liquid assets (extremely HQLA) and high quality liquid assets (HQLA) and on operational requirements for liquid assets. In the first of these, the EBA concludes that the calibration of the LCR as defined by the BCBS is generally appropriate also across the EU. However, the potential impact differs depending on the business model, with diversified business models tending to be more adapted to the LCR than specialized banks; and hence the EBA is proposing specific derogations for certain business models under stringent and objective conditions. The EBA also highlights that the work under way at the international level to recognise committed liquidity facilities at central banks should be taken into due consideration. In the second report, the EBA recommends that all bonds issued or guaranteed by EEA sovereigns, EEA central banks and supranational Institutions qualify as extremely HQLA. In addition, the EBA recommends that some specific categories of covered bonds, residential mortgage backed securities, corporate bonds, equities and bonds issued by local

government institutions be considered as HQLA. Although the empirical analysis shows some differences in the liquidity features of sovereign bonds, a differentiation in the supervisory treatment would reinforce the fragmentation of the single market and the sovereigns-banks loop. The delegated act the European Commission is empowered to adopt (by 30 June 2014), as per Article 460 of the CRR, to specify in detail the liquidity coverage requirement, shall be based, amongst others, on these Reports.

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Credit Rating Agencies

On 7 November 2013, the Joint Committee of the ESAs [launched a one-month public consultation](#) on the removal of mechanistic references to credit ratings in their guidelines and on the definition of sole and mechanistic reliance on such ratings. The term “sole and mechanistic reliance on credit ratings” is mentioned in Article 5b(1) of the EU’s CRA Regulation, however, neither its formal definition nor explanations of its meaning are included in the document. The Consultation Paper contains: (i) a proposed definition for “sole or mechanistic reliance”, including examples; (ii) the provisions in the three



The ESAs launched a one-month public consultation on the removal of mechanistic references to credit ratings in their guidelines.

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ESAs' guidelines that are not to be defined as mechanistic; and (iii) those provisions that are to be considered as mechanistic and therefore should be amended. The ESAs intend to refer to this definition in all their future guidelines, recommendations and draft technical standards where relevant.

On 21 November 2013, ESMA published its [finalised technical advice](#) to the European Commission on the feasibility of a network of small and medium-sized CRAs in order to increase competition in the market. The technical advice provides quantitative and qualitative information on small and medium-sized CRAs in the EU, based on the analysis of the periodic reporting obligations of CRAs to ESMA via the central repository (CEREP). It also covers some information regarding possible barriers to entry for companies that wish to conduct rating activity in the EU.

On 27 November 2013, IOSCO published an announcement regarding the establishment of supervisory colleges for internationally active CRAs. The supervisory colleges for Standard & Poor's, Moody's and Fitch held their inaugural meetings on 5-6 November in New York. The colleges for S&P and Moody's are chaired by the US SEC and the college for Fitch is chaired by the ESMA. The establishment of the colleges follows recommendations that IOSCO made in its final report on [Supervisory Colleges for CRAs](#), which was published in July 2013.

On 2 December 2013, [ESMA published a report](#) identifying a number of deficiencies in the processes for producing and issuing sovereign ratings at the three largest CRAs, Fitch Ratings, Moody's and Standard & Poor's. The report follows an investigation carried out by ESMA into the sovereign rating processes at the three CRAs, between February and October 2013. This was prompted by concerns about potential conflicts of

interests, the impact of sovereign ratings on other types of ratings, CRAs' capacity to cope with the number of rating actions during a period of high volatility, the use of bulk rating actions, and issues around the confidentiality and timing of rating actions. The investigation focused on the governance and organisation of sovereign rating activities, the adequacy and expertise of allocated human resources, the disclosure of rating information to the public, and ensuring its confidentiality before disclosure. ESMA identified deficiencies and issues for improvement in the following areas:

- independence and avoidance of conflicts of interests;
- confidentiality of sovereign rating information;
- timing of publication of rating actions; and
- resources allocated to sovereign ratings.

ESMA has not determined whether any of the report's findings constitute a breach of the CRA Regulation, and may take action as appropriate in due course.

Article 8d of the EU CRA Regulation requires ESMA to publish annually on its website a list of registered CRAs, indicating their total market share and the types of credit ratings issued. This information can be used by issuers or related third parties that intend to appoint at least two CRAs for the credit rating of the same issuance or entity to consider appointing at least one CRA with no more than 10% of the total market share, which can be evaluated by the issuer or a related third party as capable of rating the relevant issuance or entity. Article 8d(3) of the CRA Regulation requires ESMA to measure total market share with reference to annual turnover generated from credit rating activities and ancillary services, at group level. On 16 December 2013, [ESMA provided the list](#) of all the CRAs

registered with ESMA as of 12 December 2013, indicating their total market share (annual turnover was based on the calendar year 2012).

In view of ESMA's supervisory role with regard to CRAs, ESMA has adopted a Q&As document which relates to the consistent application of the CRA Regulation. This document, [published on 17 December 2013](#), is expected to be updated and expanded as and when appropriate. The purpose of this document is to provide clarity on the requirements and practice in the application of the CRA Regulation and in particular, the CRA III Regulation (Regulation (EU) No 462/2013 of 21 May 2013). It provides responses to questions posed by CRAs and market participants in relation to the practical application of the CRA Regulation.

On 19 December 2013, ESMA provided its [updated technical advice](#) to the European Commission on the equivalence between the Argentinean regulatory and supervisory framework and the EU regulatory regime for CRAs. In May 2013 ESMA's technical advice concluded that the legal and supervisory framework in Argentina was equivalent to the EU regulatory regime for CRAs. Having considered new requirements introduced in Argentina, ESMA's new report states that it believes the legal and supervisory framework in Argentina is still equivalent to the EU regulatory regime for CRAs.

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OTC (derivatives) regulatory developments

In [Issue 31 of the ICMA Quarterly Report](#), there was an update on ESMA's work to determine equivalence of certain third country regimes in the context of EMIR. Under date of 1 October 2013, ESMA's

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Chairman sent the European Commission a further [letter](#), enclosing:

- the supplement to the final report on ESMA's technical advice under EMIR on [Australia](#) regarding the clearing obligation, reporting obligation, non-financial counterparties and risk mitigation techniques for uncleared trades and TRs;
- the final report on ESMA's technical advice under EMIR on [Canada](#) regarding the clearing obligation, reporting obligation, non-financial counterparties and risk mitigation techniques for uncleared trades;
- the supplement to the final report on ESMA's technical advice under EMIR on [Hong Kong](#) regarding the clearing obligation, reporting obligation, non-financial counterparties and risk mitigation techniques for uncleared trades and TRs;
- the supplement to the final report on ESMA's technical advice under EMIR on [Singapore](#) regarding TRs;
- the final report on ESMA's technical advice under EMIR on [South Korea](#) regarding CCPs;
- the supplement to the final report on ESMA's technical advice under EMIR on [Switzerland](#) regarding the clearing obligation, reporting obligation, non-financial counterparties and risk mitigation techniques for uncleared trades; and
- the final report on ESMA's technical advice under EMIR on [India](#) regarding CCPs.

As announced in a 3 October 2013 [public statement](#), principals and senior representatives of authorities responsible for the regulation of the over-the-counter (OTC) derivatives markets in Australia, Brazil, the European Union, Hong Kong, Japan, Ontario, Québec, Singapore, Switzerland and the United States met on

ESMA now assumes supervisory responsibility for the TRs, which must continue to comply, on an ongoing basis, with the regulatory requirements set out under EMIR.

20 September 2013 at the headquarters of ESMA in Paris. The principals discussed generally:

- the application of clearing requirements to foreign branches and affiliates;
- risk mitigation techniques for non-centrally cleared derivatives transactions, such as timely confirmation, portfolio reconciliation, portfolio compression, valuation and dispute resolution;
- the need to cooperate in the implementation of internationally agreed standards on margin for non-centrally cleared derivatives transactions;
- cooperation on equivalence and substituted compliance assessments among the relevant authorities; and
- cooperation between authorities in the supervision of registered foreign entities.

The principals agreed to meet again in February 2014 to continue the discussion of the above points.

On 7 November 2013, ESMA announced that it had [approved the registrations of the first four TRs](#) for the EU under EMIR: (i) DTCC Derivatives Repository Ltd. (DDRL), based in the UK; (ii) Krajowy Depozyt Papierów Wartościowych S.A. (KDPW), based in Poland; (iii) Regis-TR S.A., based in Luxembourg; and (iv) UnaVista Ltd, based in the UK. The registrations took effect on 14 November 2013, with the

reporting obligation then set to begin on 12 February 2014, ie 90 calendar days after the official registration date. The registered TRs cover all derivative asset classes – commodities, credit, foreign exchange, equity, interest rates and others – irrespective of whether the contracts are traded on or off exchange. ESMA now assumes supervisory responsibility for the TRs, which must continue to comply, on an ongoing basis, with the regulatory requirements set out under EMIR. On 28 November, ESMA announced that it had [approved the registrations of two further TRs](#) under EMIR: ICE Trade Vault Europe Ltd (ICE TVEL), based in the UK; and CME Trade Repository Ltd (CME TR), based in the UK. These registrations took effect on 5 December (but the reporting obligation remains set to begin on 12 February 2014). ESMA has not received any further applications for TR registration.

EMIR entered into force on 16 August 2012, following which stipulated regulatory technical standards were prepared and entered into force on 15 March 2013. With respect to the continuing implementation of EMIR, ESMA's most recently updated [Questions and Answers](#) document was published on 11 November 2013. ESMA's [information page on EMIR](#) exists to provide access to the key documents and information about the regulation.

On 18 November 2013, [ESMA announced](#)

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that it had issued final draft regulatory technical standards (RTS) related to derivative transactions by non-EU counterparties. The RTS implement provisions of EMIR. EMIR provisions regarding central clearing and risk mitigation techniques also apply to those OTC derivatives entered into by two non-EU counterparties which have a direct, substantial and foreseeable impact on EU financial markets. ESMA's draft RTS clarify that OTC derivative contracts entered into by two counterparties established in one or more non-EU countries, for which a decision on equivalence of the jurisdiction's regulatory regime has not been adopted, will be subject to EMIR where one of the following conditions are met:

- One of the two non-EU counterparties to the OTC derivative contract is guaranteed by an EU financial for a total gross notional amount of at least €8 billion, and for an amount of at least 5% of the OTC derivatives exposures of the EU financial guarantor; or
- The two non-EU counterparties execute their transactions via their EU branches and would qualify as financial counterparty if established in the EU.

ESMA's draft RTS will cover OTC derivative contracts concluded after the date the RTS becomes applicable. ESMA's draft RTS have been submitted for endorsement to the European Commission on 15

November 2013. The Commission has three months to decide whether to endorse the final draft RTS and must then submit the endorsed RTS to the European Parliament and the Council.

ESMA has published a list of [CCPs established in non-EEA countries](#) which have applied for recognition under Article 25 of EMIR and which expressly agreed to have their name mentioned publicly. This list, last updated on 16 December 2013, is not necessarily exhaustive and it remains subject to further updates. The list is provided for information purposes only and it is without prejudice to any future ESMA decision of the recognition of the applicant CCPs.

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LIBOR and other benchmarks

An October 2013 [ECB monthly bulletin article](#) (pages 69-84) reviews the role traditionally played by reference rates, with a particular focus on the role that EURIBOR plays in the monetary policy transmission mechanism in the euro area. The article summarises the ECB's views on the current debate on the possible options to reform these reference rates, as well as the initiatives taken by the ECB to establish commonly agreed

principles that will strengthen the existing governance framework and to develop a next generation of reference rates that are better anchored to observable transactions and more representative of the underlying market conditions. It also presents some preliminary results of the transaction data collection exercise that was carried out by EURIBOR-EBF and supported by the ECB in order to assess the scope for a transaction-based reference rate that could act as a credible substitute for EURIBOR.

On 30 October 2013, IOSCO published a public communiqué entitled [Implementation of the Principles for Financial Benchmarks](#), in which it encourages administrators to take all the necessary measures to comply with the [IOSCO Principles for Financial Benchmarks](#) by July 2014. In the communiqué, IOSCO also requests that administrators publicly disclose every year the extent of their compliance with the [Principles for Financial Benchmarks](#), which were issued on 17 July 2013.

In [Issue 31 of the ICMA Quarterly Report](#) there was a report on the European Commission's 18 September 2013 proposal for a Regulation on indices used as benchmarks in financial instruments and financial contracts. Associated [Commission papers](#) subsequently made available include: (i) a summary of key topics on the proposal for a Regulation on benchmarks; (ii) some points of data; and (iii) a comparison table setting the provisions against the IOSCO principles. The European Parliament's *rappporteur* for this proposal is Sharon Bowles, who has produced a [draft report](#) which has been debated in ECON. The deadline for tabling amendments to this draft was 16 December 2013 and their consideration by ECON is expected on 20 January 2014, with the vote to follow on 30 January 2014.

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IOSCO also requests that administrators publicly disclose every year the extent of their compliance with the *Principles for Financial Benchmarks*.

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Financial Transaction Tax

The Financial Transaction Tax (FTT) proposal, for implementation by 11 EU Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain) under enhanced cooperation, was [set out by the Commission](#) on 14 February 2013. In [Issue 31 of the ICMA Quarterly Report](#) there was a report on an important challenge to this proposal which had arisen in the form of an EU Council legal opinion, dated 6 September 2013. This quite pointedly contradicts the legal validity of the scope of the Commission's FTT proposal. Recently, it has been reported that a Commission legal services opinion has reaffirmed the validity of the proposal, notwithstanding the argumentation put forward in the EU Council's legal opinion. Discussions continue to try and find common ground amongst the 11 EU Member States, with consideration being given to possible exemptions and modifications; but as yet there is still no formal alternative proposal.

PwC was commissioned by AFME to produce an independent assessment of the amount of [tax generated by the financial services \(FS\) sector](#). This report does not seek to compare the tax generated by the financial sector against the economic costs of the financial crises or the wider economic downturn. Instead it seeks to bring together evidence and examine the interactions with respect to

the amount of tax generated by the FS sector and its relative economic efficiency, thus drawing out the key tax policy issues for the understanding of both businesses and policymakers. The tax payment data used in this report has been collected from publicly available government or international sources. The report focuses on the countries with the four largest FS sectors within the EU-27, for which data were available: France, Germany, Italy and the UK. The report finds that, for all countries in the sample, on average the FS sector generated a level of tax that was in excess of its share of economic activity.

Oliver Wyman was commissioned by AFME to evaluate the [impact of the EU's proposed FTT on European end-users](#). The analysis in this report is based on transparent data sources, methodologies supported by existing studies, and a series of interviews with both dealers and end users. While end-users are not the intended targets of the tax, the report finds that they are likely to bear heavy costs and that these have been underestimated to date. These effects will have implications for the real economy and reduce the income generated by long term savings and corporate investments. In particular, it is believed that two effects have been underestimated:

- cascading taxes paid in the financial system are too large to be absorbed by the financial system and so would in

large part be passed on to end users;

- reduced liquidity in the system would increase transaction costs for end-users.

There would also likely be material second order effects (not quantified in this study) in the bank funding markets, on monetary policy transmission, and on the competitiveness of EU-11 banks in derivative markets and corporate banking.

Published on 21 November 2013, [FTT: the Impacts and Arguments – a Literature Review](#), is a report prepared by PwC. This report offers an impartial view and provides an indication of the expected impact of the FTT across the financial services sector, as well as the spill-over effects beyond the EU-11 states. It includes key arguments for and against the EC's proposal and the experiences of the implementation of several historical and contemporary national FTTSs. The report was commissioned by a group of 27 trade associations, financial market organisations and business groups. The executive summary of the report synthesises the key findings of the literature review in order to serve as a briefing note for policymakers and senior officials, who were sent the report to assist in their decision making processes as the debate on the introduction of the FTT continues.

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While end-users are not the intended targets of the tax, the report finds that they are likely to bear heavy costs and that these have been underestimated.



Short-Term Markets

by David Hiscock

European repo market

Leverage ratio: As reported in [Issue 31 of the ICMA Quarterly Report](#), on 20 September 2013, the ERC submitted a response elaborating its concerns about the proposed treatment for securities financing transaction (SFT) exposures; as put forward by the BCBS in its consultation on a [Revised Basel III Leverage Ratio Framework](#). The ICMA European Repo Council (ERC) continues to believe that it is important that changes be made to allow for the recognition of legally enforceable counterparty netting, under master agreements and in the context of CCP exposures; and has been taking every opportunity to explain the likely negative consequences in case such an adjustment to the proposed approach is not made. Decisions on this topic will be forthcoming in 2014.

In the meantime the UK Chancellor of the Exchequer, George Osborne, has requested that the UK Financial Policy Committee (FPC) conducts a review into the role for the leverage ratio within the capital framework for UK banks. This makes clear the expectation that leverage ratio requirements may be varied, at the firm or system level, if the FPC considers this to be necessary. The [letters exchanged](#) between the Chancellor and the Governor of the Bank of England, Mark Carney, have been published.

Shadow banking: On 4 October 2013, the New York Fed hosted a [workshop on Fire Sales as a Driver of Systemic Risk in Triparty Repo and Other Secured Funding Markets](#); and has subsequently provided [links to a number of the workshop papers](#). Associated with this topic, the FSB has been highlighting possible changes to bankruptcy law, including a proposal for

a Repo Resolution Authority as the single buyer of collateral which needs to be liquidated, so that the actual sell-off can then be managed in a coordinated manner. Nevertheless, in its 29 August [Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos](#) (section 4 at 4.2), the FSB's Recommendation 11 states that: "Changes to bankruptcy law treatment and development of Repo Resolution Authorities (RRAs) may be viable theoretical options but should not be prioritised for further work at this stage due to significant difficulties in implementation." The ERC is supportive of the FSB's current stance on this.

In mid-October 2013, the ERC sent a range of appropriate European and international officials a copy of an ICMA ERC White Paper on the subject of [Enhancing the Transparency of the European Repo Market](#). This White Paper summarises current ICMA ERC work to develop its thinking concerning the appropriate way in which to enhance transparency in respect of the European repo market, whether that may be through the establishment of a repo data repository (DR) or otherwise. A number of key official papers have been considered by the ERC, but whilst these do provide some direction the ERC perceives that many issues remain which are in need of further discussion. The ERC considers that there would be much value in progressing through official surveys (which the ERC would be very happy to help design, drawing on its own experience with the semi-annual [ICMA ERC European repo market survey](#)) to help quickly to improve the available market data and better inform discussions about necessary future steps. It appears to the ERC that most concerns could

be well addressed through appropriate collection of position data, and the ERC retains significant doubts about the need to pursue the collection of the far larger data sets which would be associated with an approach based on detailed transaction data. The ERC Chairman made similar comments at the recent [IX Annual International Repo Forum](#) in Moscow.

The ERC is actively considering the many and various matters covered in this White Paper and its thinking will continue to evolve in light of on-going developments, particularly as the public authorities continue to firm up their views regarding what is necessary. The views expressed in the White Paper therefore remain subject to change over time. Subsequently, on 28 November 2013, this White Paper was published when it appeared as an appendix to the joint ISLA/ICMA ERC response to the FSB's consultation regarding the ongoing efforts of its shadow banking workstream 5 (WS5), as mentioned below.

As explained in [Issue 31 of the ICMA Quarterly Report](#), the FSB's 29 August report, *Policy Framework for Addressing Shadow Banking Risks in Securities Lending and Repos*, sets out recommendations for addressing financial stability risks in this area, including enhanced transparency, regulation of securities financing, and improvements to market structure; and also includes consultative proposals on minimum standards for methodologies to calculate haircuts on non-centrally cleared securities financing transactions and a framework of numerical haircut floors.

ICMA ERC met with ISLA to discuss this publication and agreed that a joint letter would be sent to the FSB in order to offer to continue to contribute constructively in support of the continuing work being performed by WS5 in context of (i) QIS2 and (ii) the FSB data experts group on securities financing markets. Consistent with the spirit of this letter, ISLA and the ICMA ERC subsequently offered some thoughts on details of the design of QIS2; and then helped to promote market firms' participation in QIS2, the launch of which was officially [announced by the FSB](#) on 5 November 2013 (with a request for responses by 23 December).

Furthermore, ISLA and the ICMA ERC agreed that they would prepare and submit a joint response to the FSB's consultative proposals. Following a series of collaborative efforts, the mutually agreed version of [this joint response](#) was duly submitted to the FSB in accordance with the 28 November comment deadline.

Amongst other points, this joint response states: "We believe that the intent of the FSB's proposals for the regulation of haircuts appears broadly acceptable, although we have major concerns that the scope and application of the proposals as written could cause serious disruption to the repo and securities lending markets. We believe that the focus of these rules should be firmly on the financing of non-prudentially regulated entities, by banks and regulated broker dealers subject to prudential regulation and risk-weighted capital charges. ... Whilst the numerical floor proposals are restricted in scope in this way, the recommendation for minimum standards for methodologies applies to all market participants and this may have some serious unintended consequences". To avoid this, suggestions are made as to some refinements to the proposals, which are still believed to be consistent with the FSB's policy goals.

In addition to providing responses to the consultation on the proposed regulatory framework for haircuts, ISLA and the ICMA ERC took the opportunity of also attaching some feedback on the policy recommendations detailed in Section 1 of the FSB's policy document. Whilst it is appreciated that those recommendations are now final, it is hoped that this feedback will be useful to the FSB and authorities when considering implementation of these recommendations. This included the ICMA ERC's White Paper on the subject of *Enhancing the Transparency of the European Repo Market* (as mentioned above).

Following on from this formal consultation process, the FSB is also engaging in direct discussion with market participants to ensure that their perspectives and relevant technical issues have been appropriately understood. As part of this exercise, representatives of ISLA and the ICMA ERC participated in an FSB workstream meeting on 16 December, hosted in London by the PRA.

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ECP market

Money market funds (MMFs): As reported on in [Issue 31 of the ICMA Quarterly Report](#), on 4 September 2013, the European Commission published its proposed [MMF Regulation](#). IMMFA, which represents



IMMFA recommends that ABCP conduits with both corporate and consumer receivables qualify as eligible securitisations.

the European triple-A rated, constant net asset value (CNAV) MMF industry, has recently published its views in response to these proposed new MMF rules. In a paper entitled *IMMFA Summary Views on MMF Reform*, IMMFA suggests eight ways in which the European Commission's MMFR proposal should be amended. These suggestions relate to proposed provisions in respect of: (i) capital requirements for CNAV MMF; (ii) government liquidity CNAV MMFs; (iii) valuation of MMF assets; (iv) external data sources; (v) fund level ratings; (vi) credit quality of money market instruments; (vii) eligible securitisations; and (viii) definition of daily and weekly maturing assets for short-term MMFs.

The seventh of these, which is directly pertinent to ABCP, says: "IMMFA recommends that the provisions be amended so that ABCP conduits with both corporate and consumer receivables qualify as eligible securitisations. This will permit ABCP to continue to improve the working capital of European companies, especially SMEs and non-rated companies. The current provisions allow investment in ABCP conduits that have exposure solely to corporate consumer receivables. This effectively eliminates ABCP as an asset class for MMFs as only one such conduit exists in Europe. It also does not reflect the reality that consumer assets have a better credit track record in Europe than corporate assets."

Furthermore, IMMFA has backed this up with a set of eight *Position Papers on MMF Reform*. These position papers cover the following:

- *IMMFA Fact Sheet on Money Market Funds;*
- *The Problem with Capital Buffers;*
- *The Use of Amortised Cost Accounting;*
- *Definition of Liquidity Requirements;*
- *Fund Level Ratings;*
- *Credit Process and Internal Rating Scale;*
- *Reverse Repurchase Agreements; and*
- *Eligible Securitisations: Asset-Backed Commercial Paper.*

The last of these position papers, which is directly pertinent to ABCP, explains what ABCP is; why it is a key funding tool for European companies; the perceived unintended consequences for ABCP of the MMFR proposal; the impact this will have on the real economy; and then ends with the following IMMFA recommendation: "Since the impact of restricting ABCP exposure through the MMFR proposal contradicts the shared public policy objectives of stimulating the real economy, IMMFA suggests the following recommendations:

- ABCP conduits with both corporate and consumer receivables should qualify as eligible securitisations.
- The restriction that MMFs' aggregate exposure to securitisations should not exceed 10% of its assets should be deleted.
- The maturity of the asset pools financed in ABCP conduits should be extended to at least 5 years which matches the standard maturities of many types of pools financed in ABCP conduits (auto loans/leases, corporate / SME loans etc.)"

Since MMFs play a very significant investor role in the ECP, and especially the ABCP, market, ICMA is very concerned about the negative impact that the proposed MMFR could have on these valuable financing instruments. ICMA is supportive of IMMFA's efforts to ensure that MMFs can continue to finance origination of ECP, including ABCP. This is not just true of those aspects highlighted as being directly pertinent to investment in ABCP, but is also more generally true given that other aspects of the MMFR proposal threaten to constrain MMFs in ways which would diminish their significance as an investment vehicle.

Moody's 11th annual ABCP conference: In partnership with ICMA, Moody's Investors Service held its [11th annual ABCP conference](#), on 14 November 2013, in London, with just over 100 in attendance.

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by Ruari Ewing and
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Primary Markets

Prospectus Directive

On 8 October 2013, the UKLA issued [Primary Market Bulletin Issue 7](#) (PMB7), which included, *inter alia*, information on proposed guidance for non-equity retail prospectuses and three finalised technical notes.

ICMA [responded](#) to the UKLA's [Guidance Consultation 13/6](#) relating to [Technical Note 632.1 on Non-Equity Retail Prospectuses](#), endorsing the aim of the UKLA in ensuring that prospectuses aimed at true retail investors are drafted using language that is appropriate for such investors. However, the UKLA's proposals link retail prospectuses to prospectuses for securities with a denomination of less than €100,000. Such link to low denominations is unsuitable because it would mean offerings with low denominations targeted exclusively at institutional investors would need to comply with the proposed retail regime. This would result in institutional investors being faced with volumes of unnecessary and inappropriate disclosure given their knowledge and understanding, and issuers being confronted with an additional and needless burden of preparing such disclosure.

Separately, in relation to offerings targeted at wholesale investors, the UKLA stated in PMB7 that it understands a different approach is appropriate in these cases given the knowledge and sophistication of

wholesale investors, and it seems that the UKLA may be starting to tailor its reviews of wholesale non-equity prospectuses accordingly.

The PMB7 also provided detail on three finalised technical notes following a prior [UKLA consultation](#) to which ICMA previously [responded](#) (as reported in the [Third Quarter of 2013 edition](#) of the ICMA Quarterly Report at page 24–25). In relation to [UKLA/TN/605.2 on Supplementary Prospectuses](#), the UKLA confirmed, *inter alia*, that it does not believe a supplementary prospectus can be used to create or add new lines of securities to a prospectus, but stated that it does intend to take a more purposive approach where the amendments to be included in a supplement are such that the securities remain fundamentally the same. However, the UKLA did not include any clarification of withdrawal rights in the amended technical note. The amended [UKLA/TN/629.2 on Final Terms](#) did not change the UKLA's position that neither drafting notes in *pro forma* final terms nor a *pro forma* issue-specific summary can be included in base prospectuses, which was previously requested by ICMA. However, the UKLA has modified its approach in relation to wholesale "combined documents" under which both PD-exempt and PD-compliant securities may be offered, so that such securities note information need not be segregated. In relation to [UKLA/TN/631.1 on Zero](#)



The UKLA's proposals link retail prospectuses to prospectuses for securities with a denomination of less than €100,000.

Coupon Notes, the UKLA did not accept ICMA's submission that it would be helpful if the technical note also confirmed that any other notes which are not linked to an underlying but which redeem at something other than par also do not fall within the disclosure requirements set out in Annex XII or XX(XII), but did amend the title of the technical note to allow similar guidance addressing other types of securities to be issued in the future.

In other Prospectus Directive-related developments:

- ESMA published the [20th Updated Q&A on Prospectuses](#) on 28 October 2013. The changes mainly apply in the equity space, although there is an updated question on *pro forma* financial information (which will be effective from 28 January 2014) and a new question on the agreement of the auditor where a profit estimate is included in a prospectus.
- The [trilogue outcome](#) for Omnibus II was published on 25 November providing, in relation to the Prospectus Directive, that: (i) the competent authority of the home Member State (rather than the issuer) must send final terms to the competent authority of host Member State(s) and to ESMA; (ii) ESMA must prepare draft regulatory technical standards by 1 July 2014 on information incorporated by reference, prospectus approval,

prospectus publication, dissemination of advertisements; and (iii) ESMA must report on its resource needs arising from its duties under the Prospectus Directive.

- On 17 December, ESMA published an [Opinion](#) concluding that a tripartite prospectus should not be used in a programme context.
- ESMA published a [report](#) giving data on prospectuses approved and passported between January 2013 and June 2013 on 18 December.
- ESMA published on 21 December the [Final Report](#) on Draft Regulatory Technical Standards on specific situations that require the publication of a supplement to the prospectus, which ICMA will review carefully with its members.
- An ESMA prospectus register is expected to be available at the beginning of 2014, displaying all approved prospectuses and supplements in Europe within the latest 12 months at any given time.

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Market Abuse Regulation

On 14 November 2013, ESMA published a [Discussion Paper](#) on ESMA's policy orientations on possible implementing

measures under the Market Abuse Regulation, with a deadline for response of 27 January 2014. ESMA will be holding an [open hearing](#) on the Discussion Paper on 15 January 2014 in Paris.

The anticipated follow-up to the Discussion Paper is that ESMA will subsequently consult on draft ESMA regulatory technical standards, draft ESMA guidelines and draft ESMA advice on delegated acts for the European Commission. The timing of these consultations seems likely to depend at least partly on the publication of the finalised Market Abuse Regulation in the EU's *Official Journal*, which in turn depends on the finalisation of the separate review of MiFID. There have been some suggestions that the consultations might therefore possibly be published in May-July 2014, but that is merely speculative at this early stage.

The Discussion Paper covers buyback programmes, stabilisation, market soundings, manipulation indicators, accepted market practices, suspicious transaction and order reports, public disclosure of inside information and delays, insider lists, managers' transactions, investment recommendations and reporting of violations. ICMA is working on a response to the Discussion Paper, which is likely to focus primarily, in the context of Eurobond issuance, just on the new market sounding, and restated stabilisation, safe harbours.

It worth recalling in this respect that safe harbours under MAR are only necessary to the extent that conduct seen as ultimately legitimate by the authorities would otherwise risk being in breach of MAR's underlying prohibitions – the prohibitions on manipulation and improper disclosure, respectively, likely being most relevant to stabilisation and pre-sounding activities. For example, disclosure of inside information that occurs "in the normal course of the exercise of an

employment, profession or duties" should not be prohibited, even if it occurs outside the safe harbour.

A particular focus is likely to be on the detailed administrative burden imposed by the new pre-sounding safe harbour (eg in relation to cleansing obligations), as an excessive burden in this respect might risk jeopardising the market benefit the safe harbour is designed to provide.

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Packaged Retail Investment Products

On 20 November 2013, the European Parliament adopted in plenary session its report (the [provisional version](#) of which has been published) on the text of a draft Regulation under the Packaged Retail Investment Products (PRIPs) initiative. The terminology of the Parliament's text refers to key information documents (KIDs) for "investment products" rather than "packaged retail investment products" – following a proposed widening of scope beyond structured products (though still limited to retail investors as defined under MiFID).

The Parliament's text would, *inter alia*, seemingly require corporate bond issuers to:

- produce a non-misleading four-sided KID (including a summary risk indicator) that can be relied on by investors;
- publish the KID on a website, whether their own and/or perhaps that of the "relevant" regulators;
- notify the KID to the relevant regulator and provide additional information on request;
- keep the KID updated (the impact of which would presumably depend on the KID's official purpose, with the European Commission to specify exactly when this would be needed);
- produce an annual report on the "achievement" of the bond concerned against "comparable" bonds, tailored to any individual investor's portfolios that include several different securities of that issuer;
- maintain a complaints procedure;
- maintain an internal product governance process (involving target market approval and ongoing monitoring and review); and

- submit data quarterly for the ESA's online fund calculator.

In this respect, delegation (eg contracting-out of administrative processes) would not relieve issuers of responsibility or liability and KIDs would be subject to potential regulator comment (as well as the bonds to potential regulator prohibition). Issuers would have the power to withhold consent to third party use of their KIDs, which might help somewhat to manage issuer risk. There would however be no equivalent to the Prospectus Directive's €100,000 exemptions.

The Parliament's text would seem likely to involve major logistical cost (even where the relevant processes are contracted out), as well as significant liability risk (which cannot be contracted out), for issuers. This might call into question the viability of many bond issues to retail investors, though only time would really tell. This would be ironic, given the text's purported proportionality and stated purpose "to reduce costs and uncertainty for product providers and distributors".

The Parliament's text is, however, just one of three competing texts that have been expected to enter trilogue negotiations in early 2014. Some commentary on the other two texts – the European Commission's original [July 2012 proposal](#) and the European Council Presidency's [24 June compromise proposal](#) that was adopted as the Council's general approach – is set out, respectively, in the [Fourth Quarter 2012](#) and [Third Quarter 2013](#) editions of the ICMA Quarterly Report. Distinctly from the specificities of the competing texts, it remains unclear whether the Regulation will be adopted by next May's Parliamentary elections, as there are other legislative proposals which might take priority in this limited time period.

Distinctly, the Joint Associations Committee on retail structured products has published, with ICMA's participation, a





The proposal appears to be a significantly disproportionate reporting burden

response to a Joint Forum [consultation](#) on point of sale disclosure in the insurance, banking and securities sector, a response to a Central Bank of Ireland [consultation](#) on types of alternative investment funds under AIFMD and a response to a UK Treasury [consultation](#) on secondary legislation under the Banking Reform Bill.

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Bank of Italy consultation on Article 129 TUB

ICMA participated in a joint [response](#) (for which an [English translation](#) is available) to a [Bank of Italy Consultation](#) of 14 October 2013 on the *Submission of Final Reports*, under Article 129 of the Consolidated Law on Banking (TUB) on offering financial instruments in Italy. The consultation related to the introduction of a new *post-facto* reporting regime (following the August 2011 abolition of the prior *ex ante* reporting regime), for the purpose of gathering information and ascertaining the overall development of products and financial markets. The proposal requires reporting to the Bank of Italy (except to extent already so reported in the context of an Italian ISIN application):

- either by the working day following prospectus filing or, if no “filing”, by settlement;
- by (i) Italian issuers (for all deals), (ii) Italian group parent companies (for all deals issued by a subsidiary and placed or offered in Italy) and (iii) lead-managers who place instruments issued by any entity not caught by (i) or (ii) above in Italy;
- of a very significant range of information, including basic information such as currency and nominal amount, and also more detailed items such as issuer and guarantor tax code, “most important” listing venue, selling restrictions, “look-up” period, and issuer borrowing cost.

In addition: (a) further periodic reporting is required for some information such as ratings and quarterly volume and pricing of covered warrants, certificates, exchange traded notes and exchange traded commodities; (b) Italian issuers and parent companies must promptly report any updates in dynamic characteristics (such as coupons, reimbursements and ratings) and changes in static information; (c) further information is required for structured deals (including optionality basis, leverage and issue price unbundling); (d) short term, non-tradable and certain other securities are exempted; and (e) in order to limit reporting duties, other provisions of Title IX, Ch.1 of Circular 229 of 21-4-1999 are repealed.

The proposal appears to be a significantly disproportionate reporting burden (in terms of volume of information required, timing for reporting and subsequent updating) for statistical purposes only, and is out of line with information reporting regimes in other euro-area countries. This is particularly so since the required information may often need to be derived from the issue documentation by additional analysis and computation, or indeed may not be present at all in the issue documentation (though may be available on commercial data platforms). If adopted in its current form, the proposal could potentially result in (a) non-Italian issuers restricting Italian participation in international offerings; (b) Italian issuers who do not have a range of non-Italian funding alternatives available to them reducing their capital market activity and so restricting funding for the real economy; and (c) further reduction in investor choice in a time of already restricted supply.

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ICMA Sovereign Bond Consultation Paper

By Lee Goss

ICMA has published a *Sovereign Bond Consultation Paper* containing proposals to facilitate the orderly restructuring of sovereign debt.

- Since the last time ICMA consulted its members on this subject, a sovereign debt crisis has affected a number of euro-area countries, including Greece, which has restructured a large proportion of its debt through Private Sector Involvement (PSI) and a subsequent public debt buy-back initiative. The Greece case also involved substantial amounts of official sector funding from the IMF and from euro-area Member States, acceptance of a stringent economic reform and adjustment programme as well as requiring private sector creditors to absorb significant losses.
- Elsewhere, the ongoing *NML Capital v Argentina* litigation has attracted a great deal of attention, focusing the parties and commentators on the lack of clarity in a standard term of sovereign notes – in this case the *pari passu* clause – and the opportunities created by this for certain “holdout” creditors to frustrate or

block sovereign debt restructurings.

- Finally, in April 2013 the IMF published a paper on recent developments in sovereign debt restructurings. One focus of this paper was on how contract reform – including the adoption of enhanced collective action clauses – can be effective in overcoming creditor coordination problems, which in extreme cases might risk a sovereign debt restructuring failing and potentially leading to contagion threatening and impacting negatively on the stability of the financial system.

Sovereign issuers, investors, as well as other official and private sector participants have an interest in the terms and conditions of sovereign bonds being clear and unambiguous such that the parties' contractual rights and obligations are understood and easily ascertainable. This is essential to achieving pricing and market efficiency and enabling critical risk judgments to be made, often in the face of distressed market conditions, on the basis of accurate and certain information.

ICMA's primary objective is to support the orderly and well-functioning

international capital markets. This involves setting standards of best practice through contract reform and practical improvements to standard form documentation. Accordingly, ICMA is publishing a Sovereign Bond Consultation Paper and inviting ICMA members' comments on two new proposed standard form provisions for inclusion in the terms and conditions of sovereign bond issues that will facilitate the orderly restructuring of sovereign debt, if necessary.

New ICMA proposals: (i) collective action clauses

The first part of the Consultation Paper sets out new standard form collective action clauses for sovereign notes. Collective action clauses allow a supermajority of bondholders to agree to changes in bond payment terms. Thus, they allow a supermajority of bondholders to agree to a debt restructuring that is legally binding on all holders of the bond, including those who vote against the restructuring. While no panacea, they are widely regarded as the best means to overcome creditor coordination problems in the absence of a statutory insolvency regime for sovereigns.

ICMA, along with the G10, were early movers in promoting and adopting standard form model collective action clauses over ten years ago. Today, most emerging market sovereign debt issues have collective action clauses in their foreign law governed instruments.

However, holdout creditors can stop a restructuring if they can establish blocking positions on individual bond series, while a high overall participation rate in the restructuring process is still achieved. ICMA is therefore proposing the addition of a further refinement to its current collective action clauses in order to address the problem of blocking minorities by the addition of an



ICMA is publishing a Sovereign Bond Consultation Paper and inviting ICMA members' comments on two new proposed standard form provisions.

aggregation mechanism. Aggregation allows voting across multiple bond issues. In most cases, aggregation requires a double majority vote – the first conducted across all series, and the second vote, for each affected series of bonds. ICMA's new model collective action clauses as proposed will feature for the first time an aggregation mechanism, with a double majority vote, which is the approach that has been taken with the euro-area model collective action clause that became effective this year and is mandatory in all new euro-area government securities with a maturity of greater than one year.

New ICMA proposals: (ii) pari passu

The second part of ICMA's Consultation Paper sets out a *pari passu* provision for inclusion in the terms and conditions of sovereign notes. *Pari passu* means in equal step or side by side and the clause in a bond issue means that one debt will be treated the same as another. The court in *NML v Argentina* by giving the *pari passu* clause a very broad interpretation has caused considerable uncertainty for future sovereign debt restructurings, especially if coupled with the remedies so far granted by the US courts, potentially frustrating or blocking a debt exchange or other debt restructuring and discouraging other investors from taking part in an exchange offer even if they were otherwise willing to do so.

As a consequence of the market uncertainty regarding existing *pari passu* provisions and the number of different formulations in the market, ICMA proposes a revised provision which will detail clearly the scope of its application, and thereby remove the risk of the *pari passu* clause being a basis for obstructing future sovereign debt restructurings.

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Corporate Issuer Forum

The ICMA Corporate Issuer Forum (CIF), which began its activities in 2013, has met three times and twice by phone during the course of the year. Membership has continued to grow and now comprises ABB, Anglo American, ArcelorMittal, BASF, BAT, BP, Daimler, E.ON, Enel, GDF Suez, Holcim, Linde AG, National Grid, Nestlé, Rio Tinto, Siemens, Statoil, Syngenta, UK Power Networks, Unilever and Vodafone.

A number of key themes formed the agenda for the CIF in 2013, all of them relevant to the CIF members while leveraging off the expertise and broader workstreams in which ICMA is currently engaged.

A perennial focus for the CIF is regulation which is currently having an impact on the primary debt markets. With respect to the Prospectus Directive, the CIF discussed with an expert from a leading law firm Euro Medium-Term Note (EMTN) documentation, with a particular focus on prospectus standards, disclosure requirements and litigation risks, as well as logistical aspects of updating, drawing-down and listing under EMTN Programmes. EMIR was also explored during the course of the year with two all-parties calls with ISDA focusing on EMIR reporting obligations and timings.

Market practice-oriented themes also featured, culminating in a CIF discussion with a market expert on new issues processes and syndication matters, including wall-crossing, issues associated with bookrunners, price iterations, allocations and secondary market transparency.

We are very grateful for the continued enthusiasm and openness of the CIF members, whose active participation has ensured that the CIF remains a high-level platform for constructive debate and output. We are also very appreciative of the guests who took the time to attend and present at the meetings in 2013, and we look forward to another productive year ahead with a variety of interesting and relevant workstreams.

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Public Sector Issuer Forum

By Nicholas Pfaff

Nearly two years after its formation, the Public Sector Issuer Forum (PSIF) – created for “sovereign debt issuers, supranationals and agencies undertaking debt capital market transactions in the European markets” and as a “specific forum to hold confidential market practices discussions in a neutral, apolitical and cooperative environment” – has become a key committee which is supported by ICMA through a Secretariat based in Paris. The PSIF is notable for its wide membership and governance, as well as the quality of its reflection on market issues and its senior dialogue with regulators.

The PSIF brings together the major Sovereigns, Supranationals and Agencies (SSAs) actively issuing in the European capital markets. The PSIF currently has 30 institutional members including the majority of European DMOs, the European Commission (as an issuer), key Agencies such as Kreditanstalt für Wiederaufbau (KfW) and the leading multilateral development banks, including the European Investment Bank and the World Bank. The Forum is coordinated by a Steering Committee with three senior representatives (Madelyn Antoncic, Vice President and Treasurer, World Bank; Frank Czichowski, Senior Vice President and Treasurer, KfW; Anne Leclercq, Director Treasury, Belgian Debt Agency). Each represents a key SSA constituency.

The participants share, through confidential discussions, experience and concerns from their capital markets activity, focusing both on market practice and on the impact of increasing regulation on their operations. The PSIF acts as an information exchange among a group of senior government and public sector officials, and is not a lobbying or advocacy group. Participants individually decide whether to follow up any particular points arising from PSIF meetings in their own organisations or through their respective national channels. Exceptionally, the PSIF may choose to act collectively on a matter of sufficient common concern.

Since its inception the PSIF has focused on a number of market-related matters, such as derivatives clearing and the increasingly systemic role of CCPs; the possible

impact of the proposed Financial Transaction Tax (FTT) on debt capital markets; and the importance of the European and US repo markets as well as their differences in structure. During 2013, the PSIF met senior representatives of the European Securities and Market Authority (ESMA), the European Banking Authority (EBA), and most recently the New York Federal Reserve Bank of New York during the annual meeting of the World Bank last October in Washington. Previously in 2012, the PSIF had also benefitted from a high level meeting with the European Commission’s DGMARKT.

The PSIF’s dialogue with regulatory authorities is characterised by a high degree of trust and openness. This reflects its role as a channel through which senior public sector officials active in the capital markets can comment and give objective feedback on matters of concern – often on topics also raised by other market participants and operators.

The PSIF has also successfully avoided duplication and overlap with existing groupings for SSA issuers, such as the Economic and Financial Committee (EFC) Sub-Committee on EU Sovereign Debt Markets and the World Bank’s Government Borrowers Forum. Moreover, based on the feedback of its members, it has actually filled a valuable niche that is proving beneficial generally to SSA issuers’ dialogue and representation. This has been facilitated by information sharing and common membership at a senior level.

Going forward, the PSIF aims to build on this momentum under the leadership of its Steering Committee. A further controlled expansion of its membership is likely. The agenda for 2014 will include further high-level interaction with regulators, and a continuing focus on market issues and developments pertinent to SSA issuers, as well as often to the wider debt capital markets.

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Infrastructure bonds

by Katie Kelly

Bank loans have traditionally been the life blood of the infrastructure sector. However, a decline in long-term bank lending, together with the disappearance of many monoline insurers in the wake of the financial crisis, have massively affected the sector: first, bank financing is no longer as readily available; and second, the credit enhancement that a monoline insurer would have provided (in the form of a guarantee) no longer exists. Coupled with these factors is general austerity – public sector funding is generally being reduced owing to government cut-backs on infrastructure spending (although there are signs of revival, not least in the UK), all of which serves to hamper economic growth.

From the point of view of the investor, infrastructure bonds are seen as fundamentally riskier than corporate bonds with a dubious risk/return balance. Although infrastructure bonds are long-dated and will tend to be kept for the duration, the construction phase – when it may be unclear what the returns will be, the extent of any cost overruns, or the expected completion of the project – is particularly risky. This phase was traditionally financed by the banks, and refinanced by the public or private sector

once the project was able to produce tangible returns and when the risk profile shifted to performance risk related to actual cash flows generated by the project compared with forecasts.

A further concern for investors is that, owing to the long term nature of the finance, regulations and legislation will change over the period. Added to this is the need for cross-party political consensus, where there is little impetus for gaining populist votes and therefore little scope for political interference, for instance with more controversial projects such as windfarms.

Currently, a redoubtable obstacle to infrastructure bond financing is cumbersome procurement and planning procedures. EU procurement law has a “one size fits all” approach, which does not lend itself to large, one-off infrastructure projects. Added to this is a disconnect in culture and *modus operandi* between financing and procurement departments, where there tends to be a fundamental distrust of the capital markets (maybe borne out of a reliance on the more straightforward and less volatile bank funding model). Additionally, planning periods can be lengthy, and



It is clear that alternative ways of funding infrastructure projects are necessary.

the resulting consultation and resolution processes can be complex.

However, in spite of the obstacles highlighted, it is clear that alternative ways of funding infrastructure projects are necessary; in the UK for instance, the Government recently announced a projected £375 billion of planned public and private sector infrastructure investment over the next 15 or so years. And in spite of investor concerns, given that the differing risk profiles of infrastructure bonds often conveniently match the risk profiles of diverse investors, it is clear that there is strong institutional investor demand for the product and the yield – not least from the insurance sector, for which long-term investment is now easier under Solvency II.

Nevertheless, the fundamental conundrum remains that, on the one hand, greater investment from the public and private sectors will not only provide funding, but will also reassure others to invest and therefore encourage deal flow. On the other hand, it may take more sustained deal flow for the public and private sectors to start considering infrastructure bonds as a credible funding and investment tool.

One of the ways to reassure investors is to enhance the attractiveness of infrastructure bonds by way of credit enhancement. Much has already been achieved in this area, such as the EIB Project Bond Credit Enhancement initiative, where the debt of the project company is split into a senior and a subordinated tranche. The subordinated tranche – namely the Project Bond Credit Enhancement, provided by the EIB

with European Commission support – increases the credit quality of the senior tranche to a level where most institutional investors are comfortable holding the infrastructure bond for a long period. The subordinated tranche can take the form of a loan, which is given to the project company from the outset, or a contingent credit line which can be drawn upon if the revenues generated by the project are not sufficient to ensure service of the senior debt. The support will be available during the lifetime of the project, including the construction phase.

Furthermore, replacing bank financing with bond financing requires not only a change in mind-set by the project sponsors, but also a sound understanding by investors of a field of finance which differs from corporate finance. In this regard, education of, and communication between, the relevant bodies are both of key importance.

Together with promotion of education and communication, further initiatives such as credit enhancement should continue to be encouraged and expanded with a view to ensuring growth of the infrastructure bond market in the right direction – an objective which has the support of ICMA. ICMA is well placed and keen to make progress in this area with other interested parties and trade associations in 2014.

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Green bonds

by Nicholas Pfaff

ICMA aims to play an active role in providing advice and support to ongoing efforts to underpin the growth of the Green Bond (GB) market by ensuring continuing good practice. A GB is generally defined as one where the issuer declares the proceeds will be used for the reduction of CO₂ emissions and/or environmental sustainability purposes.

In 2008, the World Bank launched its *Strategic Framework for Development and Climate Change* to help stimulate and coordinate public and private sector activity in this area. In 2008, as a practical outcome of this strategy the World Bank issued a [SEK2.7 billion bond](#) thereby launching the GB market. The World Bank has subsequently continued actively to support this innovation and remains the largest issuer in the market with more than [\\$4 billion](#) raised as of August 2013. Other key multilateral institutions such as the European Investment Bank, the International Finance Corporation, the European Bank for Reconstruction and Development, and most recently the African Development Bank have followed suit contributing to an outstanding pool of GBs from multilaterals estimated in mid-2013 at \$7.4 billion.

As the market has developed, investors focused on understanding the underlying environmental projects and their impact have been able to seek guidance from third parties providing certification, evaluation and rating services (amongst others CICERO, the Climate Bonds Initiative, Sustainalytics and Vigeo). Other types of issuers have also joined the GB market in the wake of the multilaterals. They are, for example, regional and local authorities such as Région Ile de France and the Commonwealth of Massachusetts. More recently, banks (Bank of America Merrill Lynch) and corporations (Vasakronan, EDF) have also entered the market. [EDF's GB](#) at €1.4 billion is the largest from these new issuers and is exclusively dedicated to financing future renewable energy projects led by EDF Energies Nouvelles, a wholly-owned subsidiary. These developments illustrate the growing diversity of issuers beyond multilaterals and their [core](#)

[investor base](#) for GBs. It also creates new challenges.

Indeed, GB issuers typically make a number of representations to investors with respect amongst others to use of proceeds and reporting. In the case of multilaterals, such representations and resulting obligations are backed up by the *modus operandi*, budget, legal set-up and public sector ownership of these institutions. For private sector banks and corporates, GB issues involve specific undertakings over time that need to be clearly understood by all parties involved in the transaction. As a result, there has been a perception from a number of key GB issuers and intermediaries that the market's growth requires further guidance on good practice and standardisation.

In this respect, the World Bank has been active in bringing together issuers, intermediaries and investors to discuss these topics and possible guidelines. Similarly a group of major underwriters, the Green Bond Steering Committee (GBSC), have been working on a market initiative the *Framework for Green Bonds* that was originally published in a [Euroweek supplement](#) last October. The Framework aims to "maintain the integrity" of the GB market for the benefit of issuers and investors alike, and to bring together generally all parties involved in the market. It is a set of voluntary guidelines that will allow market participants to "communicate about the characteristics of any given Green Bond". It addresses key points such as definitions of different categories of Green Bond, as well as use and management of proceeds, certification and reporting.

ICMA is involved in these discussions both directly and through its relevant committees. It wishes to contribute as much as possible to standardisation and good market practice in the GB market, and aims to support the institutionalisation of ongoing initiatives in this direction.

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Other primary market developments

In other developments, the revised Transparency Directive (TD) was published in the EU's *Official Journal* on 6 November 2013. As reported in the [Third Quarter of 2013 edition](#) of this Quarterly Report (at page 30), there were no major concerns for the new bond issuance process arising out of the TD review. Interestingly, the amended TD provides that a web portal serving as a European electronic "access point", developed and operated by ESMA, shall be established by 1 January 2018 and Member States must ensure access to their central storage mechanisms via the access point. Such a portal could conceivably provide direct links to all relevant information allowing the public to easily search for information across all member states (building on the ESMA prospectus register mentioned above), or, less usefully, provide links to the national storage mechanisms.

Separately, ICMA submitted a response on 29 November to the [Interim LIBOR Oversight Committee/BBA LIBOR Joint Consultation Paper on LIBOR Refixing](#). The consultation proposed, *inter alia*,

a second afternoon LIBOR fix (to cure any errors noticed by then), which would also be "as of 11.00 am" for that day. Reflecting such an approach when determining the coupon payments due on specific bonds would be very difficult from a logistical perspective and might trigger needless uncertainty as to which rate would apply to individual bonds. Confidence in the future LIBOR will be best bolstered by strong governance processes around how individual contributions are produced and then collated, and transparent residual fallback procedures to ensure that a single and reliable rate is produced each day, which should mean that no refixing is necessary.

ICMA published on 17 December [revised ICMA Recommendation 1.31](#) (replacing the existing ICMA Recommendation 1.31 in the [ICMA Primary Market Handbook](#)) on some aspects of the interaction between lead manager(s) appointed to actively run the order book for a transaction and other lead managers without responsibility for the order book. The purpose of the revision to the Recommendation is:

- to clarify that there is no expectation that lead managers who are not responsible for the order book would have access to order book data, but rather they would just have access to final distribution data;
- to recognise that lead managers who are not responsible for the order book should be (i) appointed in sufficient time prior to announcement of the transaction to allow them to familiarise themselves with the transaction, and (ii) invited to participate in due diligence calls; and
- to clarify the terminology of the Recommendation with respect to references to managers who are not responsible for the order book.

ICMA published on 17 December revised ICMA Recommendation 1.31.

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**by John Serocold and
Katie Kochmann**

Secondary Markets

MiFID II package

While important details of the MiFID II package remain to be settled, we can now see the broad contours and the full importance of this wide, deep and detailed intervention in financial markets.

We have written before – in the ICMA Quarterly Report for the *Third Quarter* and *Fourth Quarter* of 2013 – about the chief concerns of ICMA and its members: particularly mandatory public transparency in the fixed income markets; the possibility of a requirement to trade bonds only on trading venues (RMs, MTFs and OTFs) or through SIs (the “trading obligation”); “third country” issues and the access question.

On the first of these, the detail of the proposals is still being worked on at a technical level. It is welcome that there is recognition that liquidity is a key factor in shaping the transparency regime.

It is for that reason, among others, that we recently launched a survey of current market conditions, focusing particularly on liquidity. We are looking at the secondary markets in investment grade corporate debt as well as syndicated sovereign issues.

The purpose of the research is to gather statistics which can be used to inform the debate about the detailed implementation of the new transparency regime in Europe. (Further information about the liquidity survey can be found in the box below.)

While it is not yet certain, it appears that the trading obligation for liquid bonds has not found favour with the co-legislators in trilogue. This is to be welcomed, as the market believes that a trading obligation could have serious adverse consequences, which might include a shortfall of liquid collateral, higher costs for issuers and investors and a further reduction in diversity and choice among the dealer community.

The third area of concern for ICMA and its members is the relationship between the EU single market and other countries, called “third countries” in the jargon. Here, it seems likely that the final shape of the regime will be a compromise between the *status quo*, under which third country firms are admitted to offer their services in individual Member States on the basis of national laws, and a single market measure allowing third country firms access to the whole single market from one entry point. Among the issues causing concern in this area are the requirements for a firm servicing retail customers to have a branch in the EU and for a firm to submit disputes between it and its customers to a local court.

Once the Level 1 text is agreed, the work of developing detailed rules will begin. Soon after political agreement, we expect to see a discussion paper from ESMA setting out its approach. We continue to discuss with other trade associations



It is not yet clear whether we shall be obliged to migrate to T+2 or whether we shall have an option to do so.

how best to share the work to be done at Level 2; we are conscious of the need to promote economy of effort and to avoid duplication; there is more than enough work to do!

Another area where important details remain to be settled is the question of access among market infrastructures. For many years, the international capital market has supported and implemented a policy of diversity and choice: working to ensure that market participants had a choice of settlement house, for example as well as a choice of dealer with whom to transact.

While valuable strides have been made in developing the possibilities of choice in other securities markets, it is the case that there is resistance in some quarters and it remains to be seen how widely the benefits of choice will be extended in this legislation. As [previously](#) mentioned, this is an issue to which the international markets attach great importance.

It remains important that this landmark reform of European financial markets should help to promote the move towards market-based financing which is already occurring. This shift is in the interests of the ICMA and its members.

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Central Securities Depositaries Regulation

Negotiations on the Central Securities Depositaries Regulation (CSDR) reached political agreement on 18 December 2013 and we expect that the final text will be available early in the New Year. All parties to the negotiations – the European Council, the European Parliament and the European Commission – regarded it as important to resolve the outstanding issues in good time for the legislation to complete its passage into law by the early spring of 2014. While we very much welcome this timely agreement, we acknowledge that further work remains to be done at Level 2 and we look forward to contributing to this.

T+2: The CSDR will require implementation of T+2 in the first half of 2015; and potentially with effect from 1 January 2015. Already, a number of equity exchanges have announced their intention to migrate to a standard settlement cycle of T+2 over the weekend of 4/5 October 2014. This in turn will mean a particularly heavy settlement workload on Wednesday 8 October, which will be the settlement day for Friday 3 October and Monday 6 October.

T+2 – impact on ICMA rules: One of the open issues at the time of writing is the application of the new provisions to over-the-counter trades and we shall want to look carefully at the agreed text. So for trades done under ICMA's Secondary Market Rules and Recommendations, it is not yet clear whether we shall be obliged to migrate to T+2 or whether we shall have an option to do so. In the latter case, the question arises whether it is preferable to

move to T+2 for all trading or only in cases where ICMA rules are displaced by the rules of the platform (exchange or MTF) on which the trade was done. Platforms will be migrating to T+2.

Despite the speed with which equity markets are moving, the date by which the market needs to move is sufficiently far off to allow for a period of reflection.

CSDR – impact on the ICSDs: As [previously](#) reported, the CSDR will change the regulation of the ICSDs significantly and we remain alert to the possibility of adverse consequences in this area. For now, the preliminary indications are that the changes will be manageable – but much depends on the granular detail yet to be developed, in this as in other areas.

Settlement discipline: Another area where the CSDR introduces significant changes is in the field of settlement discipline, including the possibility of daily penalties for late settlement and mandatory buy-ins. From the [Commission's announcement](#) on 18 December, it seems that the political agreement preserves the principle of a mandatory solution (buy-in) for settlement fails with a "certain degree of flexibility tailored for the needs of SMEs and specific transactions such as repurchase agreements." This is welcome, because it remains particularly important for the repo market to be provided with flexible arrangements, as the GMRA provides for alternative remedies which are better suited to the characteristics of the product. Given the low margins of much repo, daily *ad valorem* penalties would be enormously disproportionate and would damage the market.

ICMA and its members continue to believe that buy-ins for ordinary cash bonds should be initiated by the unsatisfied buyer, rather than some central authority on a mandatory basis. We also believe, in common with a range of other interested parties, that the settlement discipline regime should be implemented at

European level only after completion of a number of projects to improve settlement efficiency and connectivity between the various national CSDs and the ICSDs.

Settlement discipline – timing: In early November, ICMA and the ERC co-signed a letter with EACH and ECSDA, the principal trade associations for financial market infrastructures in the EU and two of the leading banking associations, EBF and the ESBG. We asked the European co-legislators to take into account the following constraints as regards the timing of implementation of the settlement discipline regime set out in Article 7.

We expect the timing for implementing the settlement discipline regime to be the same as for most other CSDR provisions, in the first half of 2015. At the same time, it will be necessary to introduce T+2.

We believe that such a timetable is far from optimal. The settlement discipline regime would be implemented just after some markets have moved to T+2, and potentially just before some other markets move to T+2. Market participants will need time to adapt to T+2 (from the current T+3) and it is quite conceivable that the number of settlement fails will temporarily increase in the first months following T+2 implementation. Implementing a new discipline regime just in this period could be counterproductive and generate unwelcome disruption in financial markets.

CSDs and their participants need sufficient time to make the technical adaptations required by the new discipline regime. Given the crucial developments under way to prepare for TARGET2-Securities implementation in many EU markets, as well as developments to support same-day repo and triparty system interoperability (which will ultimately support higher rates of on-time settlement), the complexity, time and resources required of all actors to implement the future CSDR discipline regime should not be underestimated. The

migration onto TARGET2-Securities will take place in between June 2015 and the beginning of 2017.

As a result, we have suggested that the European co-legislators should consider the introduction of a transition period, during which settlement fails will be monitored by infrastructures and regulators (perhaps including a special monitoring and reporting regime by ESMA), prior to the full implementation of the new discipline regime. This fixed transition period would serve to monitor the expected effects and benefits from harmonisation of the settlement cycles within the EU. Once harmonisation on T+2 has taken place and TARGET2-Securities is implemented in the participating markets, the effects on settlement efficiency can be reconsidered and provisions for a harmonised settlement discipline can be implemented – if warranted. A transition period would also give market participants at all levels the opportunity to anticipate and correct potential problems in relation to the numerous changes being implemented simultaneously. It would also ensure that infrastructures and their users have had sufficient time to develop robust systems to deal with the new regime and to minimise fails.

While we fully recognise that the harmonised settlement discipline regime under CSDR Article 7 will also contribute to further the benefits of TARGET2-Securities, we do not believe that full implementation of Article 7 is a pre-requisite for the first T2S migration wave in June 2015 but would be even more likely to hamper its successful implementation owing to the many resources which will be committed to the migration to TARGET2-Securities.

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Secondary market liquidity

At the beginning of December, ICMA invited sell-side members to participate in a survey to measure liquidity in cross-border secondary bond markets. This initiative followed discussions with our contacts in the secondary market who have suggested that secondary market liquidity remains poor. A number of suggestions have been put forward about why this might be. We believe that responses to a survey on secondary market liquidity can provide useful anonymised and aggregated information to the public domain so that market participants, policy makers and others with an interest in the bond markets can have access to facts about current market conditions against which the impact of forthcoming regulatory change can be assessed. We have developed a set of questions, both quantitative and qualitative, that seek data about stocks and flows as well as information about how secondary market participants see market quality. Participation is voluntary and individual responses will be kept confidential. Over time, we hope the survey will build a picture of the state of liquidity in the international secondary markets in investment grade corporate debt, syndicated sovereigns, supranationals and agencies. We hope to publish a report following collated responses in the first quarter of 2014. Further information about the liquidity survey can be found in the ICMA Quarterly Report for the [Fourth Quarter](#) of 2013.

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Asset Management

by Dr. Nathalie Aubry-Stacey

The asset management industry in the next five years

At the ICMA Asset Management and Investors Council (AMIC) meeting held on 20 November 2013 in London, Bob Parker, Chairman of the AMIC, presented his views on the key trends shaping the future of the asset management industry.

Structural changes in the asset management industry

Bob Parker noted the decline in bank-owned asset management businesses: the switch from bank-owned businesses to independent companies has in fact now largely occurred. He expects banks to focus on asset allocation and alternative products and on asset management for their non-institutional clients. He believes that independent investment companies will see increased consolidation and that setting up boutiques will become increasingly difficult.

He said that there is clear evidence in the loan markets of assets being transferred from deleveraging banks to asset managers. This process has now largely taken place.

Since 2008, asset allocation products have generally seen strong performance and investor inflows. This growth has been associated with the decline in the use of market benchmarks and the switch to absolute return products where excess performance is required either relative to LIBOR, inflation and/or perceived risk-free benchmarks.

Finally, he said that investors with long tail liabilities

such as pension funds are increasingly switching from liquid markets into less liquid sectors. Real estate and infrastructure are illiquid proxies for fixed income assets, while private equity is viewed as an illiquid extension of plain equity investment.

Regulatory issues to be considered by the asset management industry

Bob Parker also set out the main regulatory issues that need to be considered by the asset management industry:

- *Capital adequacy:* Increasingly, regulators will perceive asset managers as potentially representing systemic risk and therefore will demand higher levels of capital. Increased capital will depend upon whether investment products are leveraged, an assessment of the economic impact of a fund management firm failing and whether guarantees are provided to clients.
- *Shadow banking:* The regulatory focus will be on shadow banking where this activity overlaps with asset management, notably in credit and duration arbitrage and involving leverage.
- *Risk management:* Regulators will want to be assured that risk management systems covering market and non-market risks are sufficient to avoid any failure of an asset management company.
- *Transparency in selling:* Given the regulatory fines for mis-selling, asset managers will have to ensure that products are clearly explained, that risks are identified and that products are consistent with client needs.

- **Governance:** Apart from good governance procedures for managing their own businesses, clients and regulators will require increased surveillance of governance of companies in which fund managers are invested.

The full version of [Bob Parker's paper](#) is available on the ICMA website.

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Covered bonds

The ICMA Covered Bond Investor Council (CBIC) published a statement on 17 December 2013 supporting the inclusion of covered bonds as extremely high quality liquid assets under the Liquidity Coverage Ratio (LCR) within the new liquidity provisions for the European banking sector. The CBIC statement highlighted three main points to support its position:

- First, the CBIC highlighted the fact that the covered bond market did continue to function throughout the crisis and offered banks a useful and reliable funding tool even in extremely difficult market conditions back in 2008. The statement referred to the study conducted by Dick-Nielsen, Gyntelberg and Sangill (2012), as quoted in [the EBA Discussion Paper](#) on *Defining Liquid Assets in the LCR under the Draft CRR*, which examined the secondary market liquidity of government and covered bonds in Denmark before, during and after the 2008 financial crisis. The study found that the liquidity of both government and covered bonds worsened during the crisis period. Whilst government bonds outperformed covered bonds before the crisis, the liquidity of the two instruments

was broadly similar during the crisis. Therefore the liquidity of covered bonds declined less than that of government bonds during the crisis, although overall liquidity conditions were similar across the two markets.

- Second, the CBIC statement also pointed to the empirical study undertaken by the EBA itself. This was presented at the EBA public hearing on *Liquidity Reports*, which took place in London on 23 October 2013, highlighting that there was only a very small quantitative difference in terms of liquidity between government bonds and covered bonds while the other asset classes considered showed a significant difference in terms of liquidity.
- Third, the CBIC referred to the statement made by European leaders ([on 29 June 2012](#)) that one of their aims was "to break the vicious circle between banks and sovereigns through the European Stability Mechanism". If the aim was to reduce the interdependence of sovereign and bank creditworthiness, the EBA's own technical findings show that covered bonds would help support this aim and diversify banks' LCRs.

The CBIC therefore believes that recognising covered bonds as extremely high quality liquid assets is fully justified in the context of technical findings and empirical evidence and in the light of recent regulatory announcements.

The EBA published its final recommendations on 20 December – excluding covered bonds from the extremely high quality liquid assets category. The European Commission is expected to reach its final decision on this matter by mid-2014.

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The CBIC believes that recognising covered bonds as extremely high quality liquid assets is fully justified.

Use of dealing commission rules

On 25 November 2013, the UK FCA launched [its consultation on The Use of Dealing Commission Rules](#). The changes are designed to clarify the FCA rules which allow investment managers to use dealing commission for purchasing certain research goods.

The FCA Consultation Paper sets out the three main areas under review:

- clarifying the criteria for research goods and services that can be purchased by investment managers' dealing commission paid from customers' funds;
- defining corporate access and providing guidance on how investment managers should treat corporate access under the use of dealing commission rules; and
- guidance on making mixed use assessments where investment managers purchase bundled brokerage services that contain both research and non-research elements, to ensure only research is paid for with dealing commission.

This Consultation Paper forms part of a broader discussion, launched by [Martin Wheatley at the FCA Asset Management Conference in October 2013](#), on whether wider reforms are needed in the longer term to address shortcomings in the use of the dealing commission regime.

The deadline is set for 25 February 2014. The AMIC intends to respond to this Consultation Paper.

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Best practice for governance research providers

In February 2013, ESMA published its [Feedback Statement on the consultation on the role of the proxy advisory industry](#). ESMA concluded that it did not identify clear evidence of market failure in relation to how proxy advisors interact with investors and issuers, and that the introduction of binding measures was not justified. However, ESMA also highlighted several areas, in particular relating to transparency and disclosure, where it believed a coordinated effort of the proxy advisory industry would foster greater understanding of the services provided by

the industry. ESMA considered that the appropriate approach was for the proxy advisory industry to develop its own Code of Conduct.

An [Industry Committee](#) was formed – independent from ESMA – to draft [Best Practice Principles for Governance Research Providers](#). The consultation period ran to 20 December 2013. The [AMIC responded](#) in a general letter to the Committee supporting the initiative to have a Code that would give sufficient flexibility to accommodate different strategies, approaches and models while ultimately providing asset owners with relevant information.

AMIC members hope the *Best Practice Principles* will achieve better transparency on some issues, notably conflicts of interest. It is recognised that the use of proxy advisors allows investors to embrace more easily their responsibilities by facilitating their work on a difficult, technical and concentrated (short proxy season) issue. However, it also remains clear that the responsibility of the actual vote fully belongs to the investor.

It is important for AMIC members that this new Code should take into account the other Codes of Governance and their relevant sections on proxy voting and advisory service. The key is that there should be clear transparency on procedures of engagement (with companies and investors) and meaningful disclosure on conflicts of interest. Moreover, the ongoing governance of the implementation of the *Best Practice Principles* was perceived to be critical to the success of this initiative as well as the quality of the information received by users. Investors as the main users of those services should be associated in the implementation of those standards.

Finally, AMIC members consider that there is a need for the Code to be followed on a European, or international, basis as the multiplication of codes would be counterproductive since the activity of proxy advisors and investors is often larger than their own domestic market.

The Committee intends to issue the final Principles in March 2014 and to review them in September/October 2014.

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A pan-European private placement market

By Nicholas Pfaff

As indicated in previous articles in the ICMA Quarterly Report (Second Quarter of 2013: *Market Financing for Smaller Companies*; and Third Quarter of 2013 *Private Placement Markets for Medium-Sized European Companies*), ICMA continues to explore the potential and the obstacles to the development of a pan-European private placement market, with an eye to the model represented by the US private placement market (USPP). As a reminder, the USPP market represented \$55 billion in total issuance volumes in 2012 made available from a group of large US insurance companies to rated and unrated, listed and unlisted, medium and large corporates. The USPP market benefits from standardised documentation, and issues receive a credit scoring from the National Association of Insurance Commissioners (NAIC), which also gives regulatory guidance on capital weighting. The USPP is also popular with many European companies, which raised nearly \$20 billion in this market in 2012.

The relevance of a pan-European private placement market must be understood in the context of Europe's debt capital markets being called upon to fill in part or in full the funding gap expected as a result of ongoing [bank deleveraging](#) (estimated by the IMF to exceed €2 trillion in bank assets by end-2013) following the 2008 crisis, and as a result of Basel III and its European transcription CRD IV/CRR coming into force. There are already countries in Europe where important domestic private placement markets have developed, such as Germany's Schuldchein market, which represents approximately €12 billion of financing per annum. There are, however, at this stage at least two interesting developments relevant to the prospects for a pan-European private placement market.

First, there is the accelerating [Euro PP market](#) in France. The Euro PP product was launched in order to help medium-sized French companies access a new source of financing. It met demand from long-term investors, mostly French insurers, who wished to diversify their portfolios. The Euro PP market is growing dynamically, with €6 billion raised since 2012. The average size of EuroPP issuance is €100 million, with a number of

smaller deals in the range of €20-40 million as well as larger transactions reaching €300-500 million for mid-caps. The emergence of this market has been shepherded by an industry committee sponsored by the Banque de France. This has especially focused on documentation standardisation (based on Eurobond documentation), which has been formatted for the local market but also with an eye to being adapted to serve as a European standard.

Second, there is also the [EPPA initiative](#). This private placement project was launched in 2013 by a number of Dutch and British parties, including NIBC, Delta Lloyd and M&G, with support from Clifford Chance and Allen & Overy, as well as reportedly from the Dutch financial market authority and the Nederlandsche Bank. The ambition is to develop initially out of Amsterdam a private placement market for corporates that would also have Europe-wide appeal.

Further to discussions with the AMIC's Executive Committee and interaction with interested buy-side parties, ICMA will now be launching a dedicated working group that will aim to identify obstacles to the development of a pan-European private placement market and how they may be overcome. It will also support market initiatives designed to help bring it about while striving to avoid overlaps amongst them. The immediate priorities of the working group have been agreed as:

- documentation standardisation;
- rights between unsecured bank lenders and unsecured institutional lenders;
- credit scoring and regulatory recognition for capital weighting purposes;
- financial information and reporting from issuers to institutional investors.

ICMA will report further on the composition, progress and output of this working group as it moves ahead.

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Market Infrastructure

by David Hiscock

Data Gaps Initiative (DGI)

At their meeting in Moscow in July 2013, the G20 Finance Ministers and Central Bank Governors welcomed the continued progress made by the G20 economies on closing information gaps under the FSB and IMF G20 Data Gaps Initiative (DGI) as a prerequisite for enhanced policy analysis. They strongly encouraged the implementation of the recommendations in this initiative, and looked forward to the [fourth annual progress report on the DGI](#) for their meeting in October 2013. This report describes progress since November 2012 and the plans going forward. It contains a number of key messages:

- Considerable progress has been made across the full range of the DGI recommendations. Significant data enhancements are coming on stream.
- The feedback from the consultation process with experts indicates that, overall, there is strong support for, and a growing sense of ownership among G20 economies in, the DGI.
- To ensure complete implementation of the recommendations, and the timely provision of comparable economic and financial statistics, the momentum behind the initiative needs to be maintained and adequate resources provided for statistical work.

- Strengthened collaboration among national agencies and continued international cooperation, collaboration, and consultation is essential for the success of the initiative.
- The strategy going forward should focus on completing the on-going work in implementing the recommendations; and communicating to policy makers and analysts the availability, benefits, confidentiality rules, and policy relevance of the enhanced and new data emerging from the DGI.
- Notwithstanding some national implementation issues that may arise, implementation of a significant portion of the recommendations is expected to be completed by end-2015.

The report seeks endorsement by the G20 Finance Ministers and Central Bank Governors of the action plans and timetables set out in Annex 1 of the report, including the key milestones presented in Figure 1 of the report.

ECB: Contact Group on Euro Securities Infrastructures (COGESI)

The work of the *ad hoc* COGESI group on collateral harmonisation is continuing. This includes follow-up to the COGESI report on collateral eligibility requirements and the drafting of an important report on the

efficient functioning of the repo market. Members of the ICMA ERC are engaged in providing input to relevant aspects of this work.

ECB: Money Market Contact Group (MMCg)

A regular quarterly meeting of the MMCg was held in Frankfurt on 10 December 2013. The agenda included: (i) a review of the main findings of the [euro Money Market Survey](#); (ii) a review of the latest market developments; (iii) the ECB's comprehensive assessment of the euro area banking system and its impact on the money market; (iv) an update on the current status of regulatory work, covering the leverage ratio, the LCR and the NSFR; and (v) updates on money market reference rates and on the on-going reform process; and on the STEP+ initiative. The next regular quarterly meeting is scheduled for 18 March 2014.

ECB: Bond Market Contact Group (BMCG)

The BMCG's fourth meeting took place in Frankfurt on 8 October 2013. The agenda comprised: (i) bond market outlook and other topics of relevance; (ii) European banks and corporates funding models; (iii) update on the ABS market and outlook; and (iv) update on the covered bond market and outlook. The full agenda,

together with a summary of the discussion and the supporting meeting papers are published on the BMCG's website pages. The fifth BMCG meeting is scheduled for 21 January 2014, with an agenda which includes discussion on the subject of sovereign funding challenges for 2014 and private sector bond issuance; latest developments of electronic trading in bond markets; and trading risk metrics.

ECB: TARGET2-Securities (T2S)

On 16 October 2013, *T2S Spotlight* highlighted the list of 31 institutions which communicated, by the deadline of 15 October, a non-binding expression of interest in becoming a directly connected party (DCP) in T2S. The DCPs will interface directly with T2S via one of the two network providers, subject to the authorisation of their respective CSD(s)/ NCB and certification by the Eurosystem. Furthermore, on 25 November 2013, T2S spotlight flagged that a T2S "train the trainer" programme was set up in recent weeks, designed to train designated trainers who in turn will train the T2S end-users during in-house courses at CSDs and central banks; and drew attention to a [website page listing the CSDs](#) which have signed up for T2S, and which represents a single point of access to all the T2S-related information provided by each CSD.

The [T2S Advisory Group](#) (AG) provides advice to the Eurosystem on T2S-related issues, to ensure that T2S is developed and implemented according to market. It met on 18-19 November 2013, in Frankfurt. Following some introductory points, members of the AG took note of the debriefing of [the CSG Chairman](#); and of the [T2S Board Chairman](#). There was then an update on the CSDR and discussion of the T2S Programme Status. Under the topic, *Use of T2S*, there was discussion of volumetric assumptions for T2S sizing and auto-collateralisation. Next, the Chairman of the [Harmonisation](#)

[Steering Group](#) (HSG), Yvon Lucas, presented the conclusions of the last HSG meeting and the AG approved the resulting decision points; and the HSG Secretary presented the updated harmonisation dashboard. Following time spent covering a number of other points, it was noted that the next AG meeting would be held on 12-13 February 2014, in Rome. The HSG itself met on 22-23 October 2013 and will next meet on 20-21 January 2014. The T2S Cross-border Market Practice subgroup ([X-MAP](#)) met on 8 October 2013, 13 November and 17 December. The November meeting focused on planning the analysis of CSD Restriction Rules, which should be finalised by the end of 2013.

On 19 June 2013, the T2S AG decided to set up an HSG task force to coordinate the different settlement cycles within the T2S Community. The [Task Force](#) will be composed of all segments of the industry: exchanges, CCPs, CSDs, intermediaries, buy side and sell side. The main objective of the task force is to facilitate broad coordination across T2S markets when migrating to T+2. The Task Force will also aim at contributing to the coordination between T2S and non-T2S markets on the matter; and the task force will report to T2S HSG. The first meeting of this task force was held on 15 November 2013, in Frankfurt, and the second is set for 27 January 2014.

An Info Session was held in [Lisbon on 13 December](#) 2013. This included presentations on: (i) T2S Project status update and next steps; and (ii) collateral management in T2S. These were followed by an insight session, entitled "Getting ready for T2S migration". This involved a presentation on the question of "What will CSDs offer their clients?" and a panel discussion on the topic of "Directly Connected Party in T2S". There was then a further short presentation on "Set-up for settlement, auto-collateralisation and client collateralisation in T2S". In addition, on 29

November 2013 in Frankfurt, a [workshop was held](#) on "Set-up for settlement, auto-collateralisation and client collateralisation in T2S". Following introductory remarks, The T2S PO presented technical details on the set-up of T2S Parties in T2S and their impact on the management of settlement flows as well as collateral and liquidity pools. Different possible implementation models were presented to the workshop participants. After this, representatives/ Secretaries of the National User Groups (NUGs) of Germany, France and Italy presented the views and discussions from their NUGs; and then participants concluded on the discussions and the way forward.

Global Legal Entity Identifier System (GLEIS)

As reported in [Issue 31 of the ICMA Quarterly Report](#), a note published by the [LEI ROC](#), dated 27 July 2013, establishes the [principles that should be observed](#) by the Local Operating Units (LOUs) participating in the Interim GLEIS as pre-LOUs. A [ROC endorsement note](#) of 3 October 2013, describes the ROC's endorsement of three pre-LOUs in accordance with the process described in Annex 1 of the principles. An [11 November 2013](#) ROC endorsement note, then describes the ROC's endorsement of two further pre-LOUs; and a [ROC endorsement note of 7 December 2013](#) reports the addition of a sixth endorsed pre-LOU. In addition to these six endorsed GLEIS pre-LOUs, there is a broader [list of four digit prefixes](#) allocated to sponsored pre- LOUs (which currently includes nine unendorsed pre-LOUs).

On 28 October 2013, EBA launched a consultation (which closed on 28 November) on a [Recommendation on the Use of the LEI](#). The EBA encourages and supports the establishment of the GLEIS. The use of pre-LEIs by the competent authorities when fulfilling their reporting obligations to the EBA will enhance



supervisory convergence and ensure the high quality, reliability and comparability of data. Accordingly, the EBA intends to require all entities for which information is required under EU reporting obligations to obtain a pre- LEI code for reporting purposes.

Separately, *ESMA's Q&A regarding the Implementation of EMIR* covers LEI usage under trade repository (TR) question 10. In response to the question "What code should be used to identify counterparties (LEIs, interim LEIs or BICs)?", the stated answer is "A pre-LEI issued by any of the endorsed pre-LOUs of the GLEIS" (an exception is allowed for customers who are individuals). As the first phase of the LEI is not expected to cover branches (or desks), the same legal entity would only have one LEI. It is therefore noted that "a particular issue for early review is for the ROC to consider whether and if so how the global LEI can be leveraged to identify bodies such as branches of international banks which are not legal entities, but which require separate identification under some cross-border resolution schemes".

A 3 November 2013 ROC [letter to business registries](#) identifies that "a vital role in the global identification system is also envisaged for the business registration number of the entity and the business registry reference where the entity is formed, as in many jurisdictions such registration defines and provides the proof of the existence of the legal entity." The letter sought confirmation, by 2 December, from the business registries that: (i) there are no impediments to entities themselves with official business registry numbers in registries providing their business registry numbers to LOUs, or the pre-LOUs, as part of their self-submitted reference data; (ii) there are no impediments to the LOUs, or the pre-LOUs, freely publishing such registration numbers, as supplied by the entities; and (iii) there are no impediments to the free use of such business registration numbers by users of

An FMI that requires collateral to manage its or its participants' credit exposure should accept collateral with low credit, liquidity, and market risks.

the GLEIS. Following from this exercise, the ROC has [published a list](#) (which it will maintain) of business registries that have provided written confirmation that there are no such impediments.

Financial Market Infrastructures (FMIs)

On 15 October 2013, the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) published for public comment a consultative document on the [public quantitative disclosure standards for central counterparties](#) (CCPs). In order that the risks related to the use of CCPs can be properly understood, CCPs need to make relevant information publicly available, as stated in the CPSS-IOSCO [Principles for Financial Market Infrastructures](#) (FMIs), published in April 2012. To provide guidance on what should be disclosed by a CCP and other financial market infrastructures, CPSS and IOSCO published a [disclosure framework](#) in December 2012, primarily covering qualitative data that need relatively infrequent updating (eg when there is a change to a CCP's risk management framework). To complement that disclosure framework, this new consultative document sets out guidance on the quantitative data that a CCP should disclose more frequently.

Amongst the principles for FMIs, Principle 5 specifically concerns collateral. This states that: "An FMI that requires collateral to manage its or its participants' credit

exposure should accept collateral with low credit, liquidity, and market risks. An FMI should also set and enforce appropriately conservative haircuts and concentration limits." Key considerations associated with this principle are:

- An FMI should generally limit the assets it (routinely) accepts as collateral to those with low credit, liquidity, and market risks.
- An FMI should establish prudent valuation practices and develop haircuts that are regularly tested and take into account stressed market conditions.
- In order to reduce the need for procyclical adjustments, an FMI should establish stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practicable and prudent.
- An FMI should avoid concentrated holdings of certain assets where this would significantly impair the ability to liquidate such assets quickly without significant adverse price effects.
- An FMI that accepts cross-border collateral should mitigate the risks associated with its use and ensure that the collateral can be used in a timely manner.
- An FMI should use a collateral management system that is well-designed and operationally flexible.

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Macroprudential Risk

by David Hiscock

IMF Global Financial Stability Report

On 9 October 2013, the IMF published its latest semi-annual *Global Financial Stability Report*, which examines current risks facing the global financial system as it undergoes a series of transitions along the path toward greater financial stability. The three main chapters in this report are: (i) Making the Transition to Stability; (ii) Assessing Policies to Revive Credit Markets; and (iii) Changes in Bank Funding Patterns and Financial Stability Issues. Subsequently, on 27 November 2013, the ECB issued its latest semi-annual *Financial Stability Review*. This included articles on the macro-financial and credit environment; financial markets; and euro-area financial institutions, as well as a number of special features. And then, on 28 November 2013, the Bank of England released its latest semi-annual *Financial Stability Report*. In addition to describing steps to ensure a resilient housing market, this considers three other strategic priorities for 2014, namely (i) helping set the medium-term bank capital framework, including by conducting a review of the role of the leverage ratio within that framework; (ii) working to end “too big to fail”; and (iii) identifying and addressing risks in shadow banking, while supporting diverse and resilient sources of market-based finance.

IOSCO Securities Markets Risk Outlook

On 15 October 2013, IOSCO published its *Securities Markets Risk Outlook for 2013-2014*. This report highlights important trends, vulnerabilities and risks in securities markets that may be of concern from a systemic perspective. The *Outlook* is the first published edition of an annual series. Its aim is to

provide IOSCO members with the information they need to adopt a forward looking approach in dealing with potential vulnerabilities and risks to global securities markets and the global financial system as a whole. The four main risks it identifies and analyses in depth relate to the following:

- *Risks related to low interest rate environment:* Expansionary monetary policies have reduced interest rates to the point that real rates are at times negative. While these policies may help stimulate the real economy, spill-over effects may create potential risks for securities markets. A search for yield is turning investors towards leverage products such as CDOs and leveraged real estate investment funds.
- *Risks related to collateral management:* In response to global policy requirements, demand from investment firms for high quality collateral has increased significantly. More generally, bank holding companies with OTC dealer operations must locate high-quality collateral to meet initial and variation margin requirements for their OTC trades. Additionally, central banks have been absorbing collateral to provide needed bank funding. This growing demand has altered the balance of collateral in the system, diminishing availability of high-quality collateral and could impact pricing.
- *Risks related to derivatives markets:* OTC derivatives markets have undergone significant reform since the financial crisis. This reform entails the mandatory clearing of derivative contracts through CCPs. CCPs are designed to reduce systemic risk in the derivatives market by reducing counterparty risk. But shifting the risk from bilateral OTC contracts to a single point of infrastructure is a challenging balancing act.

- *Risks related to capital flows of emerging markets:*

Emerging market economies have experienced significant capital inflows in the post-crisis era. Debt securities and non-bank lending have overtaken foreign direct investment and banking lending as the main source of these capital inflows. After the announcement of the tapering of the expansionary monetary policies of the Fed, a sudden reversal in capital inflow occurred, highlighting the need for further structural reforms aimed at making securities markets more resilient.

ESMA Risk Dashboard

On 15 November 2013, ESMA published its *Risk Dashboard No.4 for 2013*. The risk dashboard provides a snapshot of risk issues in the third quarter of 2013. In addition, the risk dashboard includes specific sections reporting on liquidity risk; market risk; contagion risk; and credit risk. In respect of the overall economic environment and securities markets conditions the summary commentary states:

"Systemic risk in EU securities markets remained at levels similar to those witnessed in 1H13 – high yet below those observed in more acute phases of the crisis. Market risk increased, as yield curves in advanced economies steepened, giving rise to valuation concerns. This triggered price changes and a reallocation of capital, with revaluation risks expected to continue going forward. Market concern over the US budget situation emerged as the reporting period of this edition of the Risk Dashboard drew to a close, and may be expected to endure as budget negotiations are set to continue after the compromise bill of 17 October. In the EU, aggregate risk levels did not increase further even as the focus on underlying risk factors shifted from an unwinding

of pre-crisis imbalances towards uncertainties related to policy implementation. Risk levels settled back to early-2013 levels, having ticked-up mid-1H13 in reaction to idiosyncratic events in some more vulnerable Member States (MS). Liquidity, credit and contagion risks remained broadly stable at an elevated level and are expected to remain so over the short-run."

BCBS Research Task Force

To further its goals through a variety of activities, the BCBS created the Research Task Force (RTF). One of these activities is to take on specific research projects addressing supervisory and financial stability issues. Given the importance of stress testing as a tool in developing a complete picture of an institution's liquidity risk profile, the RTF's Workgroup on Liquidity Stress Testing (RTF-LST) was mandated to draft a survey on current practices, identify gaps and – where possible – suggest ways forward. [The survey](#) is written with the broader supervisory community in mind. Many of the findings are, however, also relevant for risk managers in banks as well, given their role in measuring their institution's liquidity risk profile and enforcing risk limits. Published on 23 October 2013, [a complementary note, Literature Review of Factors Relating to Liquidity Stress – Extended Version](#), reviews the academic literature pertaining to liquidity stresses in more detail, compared to the survey. It is organised using the categories and concepts established in the LCR. In particular, the RTF-LST reviewed the literature on: deposits, loan commitments, secured funding, wholesale funding, counterbalancing capacity, secured lending, and links with non-banks intermediaries. In addition to other parts of the survey, this note can help to inform the design of stress tests.



In response to global policy requirements, demand from investment firms for high quality collateral has increased significantly.

ESRB: Central Counterparties and Systemic Risk

On 5 November 2013, the ESRB published macroprudential commentary, [Issue 6, Central Counterparties and Systemic Risk](#). This commentary provides an overview of the role of CCPs in the financial system and analyses the importance of CCPs' resilience for broader financial stability. Notwithstanding the benefits that result from the clearing requirement, the change in market organisation may lead to new vulnerabilities related to risk concentration, complex interdependencies or potential collateral scarcity. In addition, uncoordinated microprudential risk management practices could lead to systemic stress. This commentary also focuses on macroprudential concerns, such as procyclicality, wrong-way risks and interdependencies that may arise from a CCP's risk management practices and market structure. Further efforts are being made and still more may be needed in order to achieve a safe and resilient clearing landscape. Essential work on recovery and resolution arrangements for CCPs is ongoing at the international and EU levels; and further, enhanced international policy coordination across various dimensions is critical to reaching the targets set by the G20 leaders.

Other issues

The EBA [organised a research workshop](#) (aimed only at invited supervisors and academics), held in London on 14 - 15 November 2013, on how to regulate and resolve systemically important banks. Following a welcome speech from Andrea Enria, EBA Chair, a keynote speech, *How to Improve Financial Stability and Resilience of Systemically Important Financial Institutions after the Crisis?*, was delivered by Erkki Liikanen, Governor of the Bank of Finland. The workshop was then divided into four major sessions: (i) credit risk; (ii) SIFIs; (iii) systemic risk; and (iv) resolution.

On 28 November 2013, the research department of IOSCO launched a [statistics web portal](#) that provides the public with a global overview of specific securities markets. The portal will be updated on a monthly basis and represents the first step in an ongoing process to offer the public critical information on securities markets. In the coming months, the website will be further refined and developed. The

objectives of the new portal are threefold: first, it seeks to provide a centralized point for monitoring global trends, risks and vulnerabilities; second, to provide a mechanism for comparison of how well markets are recovering in light of the crisis; and finally, to provide IOSCO members and the broader financial community with easy access to key statistics, charts and indicators on a number of securities markets, including:

- corporate debt, including global and regional issuances of investment grade and high yield debt;
- covered bonds;
- securitised products, including issuance since the crisis;
- Islamic finance: sukuk bonds, with more products to be covered in the coming months;
- equity IPO volumes;
- equity market valuations: CAPE and Tobin's q measure;
- syndicated loans, including average cost of deals; and
- housing price indices of selected countries.

On 12 December 2013, the [EBA launched a public consultation](#) (until 28 February 2014) on the methodology for identifying Global Systemically Important Institutions (G-SIIs). The work aims at ensuring a transparent identification process in line with international regulatory work on global systemically important banks. The public consultation covers the draft RTS on the methodology for identifying G-SIIs, and draft ITS and Guidelines on the disclosure of the value of indicators used in the identification process. The draft ITS define uniform disclosure requirements to publicise the values used for the identification and scoring process for G-SIIs. These ensure fair competitive conditions between comparable groups of institutions, resulting in greater convergence of supervisory practices and more accurate risk assessments across the EU. In order to ensure a transparent identification process and a level playing field, the proposed draft Guidelines foresee that not only G-SIIs, but also other large institutions with an overall exposure of more than €200 billion and which are potentially systemically relevant, will be subject to the same disclosure requirement.

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ICMA in Asia-Pacific

by Mushtaq Kapasi

Introduction

ICMA's Asia-Pacific representative office launched operations in Hong Kong on 30 September 2013. Since then, ICMA has continued to strengthen ties with members, regulators, and infrastructure providers in the region.

In ICMA's recent discussions in Asia, three common themes have emerged: (i) financial liberalisation, particularly in China; (ii) recovery of the European economy, which will lead to a growth in cross-regional investment; (iii) shift from bank lending to capital market financing. Each of these trends supports and complements ICMA's efforts to develop efficient, liquid and well-governed cross-border capital markets across the Asia-Pacific region.

In Asia, as in other regions, ICMA's main focus will be on international debt capital markets and repo. ICMA also intends to promote fruitful dialogue between Asia and Europe on emerging regulations and best practices in both regions.

Asian primary markets

In October 2013, ICMA held an Asia Debt Syndicate meeting, attended by 18 syndicate managers from leading Asian underwriters. The subjects covered, including pre-sounding, book status communications, pricing iterations,

allocations, roles of underwriters, and the dynamics and risks of a growing market with many new entrants, echoed to some extent with many of the discussions in the ICMA Primary Market Practices Committee, but from an Asian perspective.

ICMA is planning follow-up discussions of Asian syndicate managers in 2014, and plans to facilitate similar discussions in Asia on the legal and documentation aspects of primary markets as well.

Repo

The repo markets in Asia, both local and cross-border, are growing quickly, but remain small and disjointed due to the variety of regulatory regimes and market dynamics. The adoption of international best practices and further adoption of standard documentation would improve liquidity, collateral risk, and market transparency. Asian repo market participants recognize ICMA's leadership in global market knowledge, regulatory expertise, underlying opinions and documentation.

ICMA has had extensive dialogue with China's National Association of Financial Market Institutional Investors (NAFMII) over the last 18 months on repo as NAFMII created its own master agreement for the domestic China market, involving

both pledge and true sale. ICMA has also led the development of legal opinions for many Asia-Pacific countries. However, enforcement for some of these is not robust, and work remains to be done to improve the relevant regulatory regimes and judicial procedures to enable more efficient markets.

Other areas of cross-regional relevance

While ICMA's focus in Asia will be on primary markets and repo, a number of other areas of ICMA's work in market practice and regulatory policy are also relevant to Asia:

- **Benchmarks:** Asian bond markets rely extensively on both international and local interest rate benchmarks, and continue to develop new ones (such as CNH HIBOR). ICMA's work to ensure that there is continuity of those benchmarks in long-term contracts, while at the same time recognising the value of rules to prevent market abuse, is of particular interest to Asian regulators and market participants.
- **Resolution regimes:** Global banks face pressure to formulate internal resolution and recovery plans to satisfy both home regulators and Asian regulators in jurisdictions where affiliates operate. Asian regulators in particular are

requiring safeguards in place to ensure that onshore liquidity and operations are not threatened in the case of difficulties in a home jurisdiction.

- **Basel III bonds:** Several Asian banks have issued or plan to issue contingent convertibles or bail-in bonds. In Asia there is considerable debate over the precise mechanisms for determining and effectuating the bail-in, and over the suitability of these bonds for individual investors.
- **Collective action clauses:** Sovereign issuers in Asia, particularly those in emerging markets, are closely following ICMA's work on a revised standard collective action clause (see article above) to balance more fairly and efficiently the interests of investors and issuers in case of a sovereign restructuring.
- **Wealth management:** Continuing its efforts to promote integrity, transparency, and professionalism in the global wealth management industry, ICMA has introduced the [Charter of Quality](#) to private banks, regulators, and local associations in Asia, and will continue to promote its adoption in the region.

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diary

ICMA organises over 100 market-related events each year attended by members and non-members. For full details see www.icmagroup.org. Most ICMA events are accredited under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. (See the ICMA website for details.)

22 JAN

ICMA European Repo Council (ERC) Annual General Meeting, Luxembourg, 22 January

The European Repo Council (ERC) Annual General Meeting, alongside formal business (including annual elections for the ERC Committee), will cover most aspects of the operation of the European repo markets, including recent regulatory and legal developments. This event is hosted by Clearstream and is open to all members of the European repo community.

[Register here](#)

23 JAN

ACI and ICMA 2014 Economic Summit and New Year's Event, Brussels, 23 January

ICMA members are invited to this annual social event taking place this year at La Tentation in Brussels. It features presentations by four prominent economists from leading banks, who will each provide a brief outlook for 2014 on the different markets, followed by a panel discussion. Organised by ACI and the ICMA Belgian region. Open to ICMA Belgian region members only.

[Register here](#)



Peter Praet, Chief Economist ECB speaking at an ICMA Capital Market Lecture in London, December



Tim Skeet, ICMA Board member chairs a panel at an ICMA Seminar on 'The Swedish Capital Market: Prospects for Borrowers and Investors' in Stockholm, December



Godfried De Vidts, Chair of ICMA's European Repo Council Panel on a panel in Moscow at the IX Annual International Repo Forum, December

ICMA EVENTS AND COURSES

03 FEB

AFME and ICMA Capital Market Lecture: Martin Wheatley Chief Executive of the UK's Financial Conduct Authority (FCA), London, 3 February

The 2014 ICMA Capital Market Lecture series, featuring senior industry figures, including regulators, government officials, central bankers and commentators, opens with an opportunity to hear from one of Europe's most influential regulators, Martin Wheatley. This event is open to ICMA and AFME members only.

[Register here](#)

04-05 FEB

ICMA Professional Repo and Collateral Management Course, London, 4-5 February

This course has run successfully for over 10 years, becoming the market benchmark. It features a blend of presentations from experienced practitioners who are actively involved in the repo market on day-to-day basis, with a sound explanation of the principles involved in this type of financing from the ICMA Centre.

As well as covering the fundamentals of the repo product, the course addresses the uses and management of repo and collateral by banks, innovations in the market, the impact of the crisis on the repo market, regulatory issues and the latest developments in the clearing and settlement infrastructure of the market.

[Register here](#)

06 MAR

European Regulation: An Introduction for Capital Market Practitioners, London, 6 March

ICMA's one day fast-track course on European regulation is aimed at sales people, traders, originators, syndicate personnel, and middle and back office staff who would benefit from a better understanding of the current regulatory landscape in the cross-border bond markets. It is specifically not aimed at lawyers or compliance staff. The focus of the programme is the cross-border capital markets and the bias is towards practitioners working largely with institutional rather than retail clients. The course provides updates on the major regulatory developments relevant to the market and will consider recent case studies in the regulatory crackdown.

[Register here](#)

18 MAR

Market Practice in Debt Capital Markets for Compliance Professionals – an ICMA Workshop, London, 18 March

This workshop aims to give compliance professionals an in-depth and thorough understanding of the current practices that are involved in launching a deal in the international debt capital market.

It explains precisely how the deal is done, starting with first steps in the pre-launch process - looking at the pitch book, the mandate, the roadshow and the prospectus - through syndication, including book building and allocation, up to and including the final public launch of the issue.

[Register here](#)



15 MAY

The ICMA CBIC & The Covered Bond Report Conference, Frankfurt, 15 May

The ICMA Covered Bond Investor Council (CBIC) and The Covered Bond Report's 2014 Covered Bond Investor Conference will focus on topical investors' issues and provide an ideal opportunity for those wishing to engage in a constructive dialogue with the buy-side.

[Register here](#)

05-06 JUN

ICMA Annual General Meeting and Conference 2014, Berlin, 5-6 June SAVE THE DATE!

ICMA Executive Education

Book now for these ICMA Executive Education courses in 2014. ICMA Executive Education courses are accredited under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme – please see ICMA website for details.

Part I, Introductory Programmes

Financial Markets Foundation Course (FMFC)
London, 7-9 May
Luxembourg, 2-4 June

Securities Operations Foundation Course (SOFC)
London, 25-27 February
Brussels, 19-21 March

Part II, Intermediate Programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Barcelona, 27 April-3 May

Operations Certificate Programme (OCP)
London, 23-29 March

Primary Market Certificate (PMC)
London, 19-23 May

Part III, Specialist Programmes

Collateral Management
London, 3-4 March

Corporate Actions – An Introduction
London, 7-8 April

Corporate Actions – Operational Challenges
London, 9-10 April

Capital Market Overview of Islamic Finance & Sukuk
London, 9-10 June

Corporate Governance and Culture
London, 16-17 June
Further specialist level programmes will be announced shortly

ICMA Executive Education Skills Courses

Successful Sales
London, 1-2 May

The full 2014 course schedule is available here,
www.icmagroup.org/Training-Development

Glossary

ABCP	Asset-Backed Commercial Paper
AFME	Association for Financial Markets in Europe
EIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BMCG	ECB Bond Market Contact Group
BRD	Bank Recovery and Resolution Directive
CAC	Collective action clause
CBIC	ICMA Covered Bond Investor Council
CCBM2	Collateral Central Bank Management
CCP	Central counterparty
CDS	Credit default swap
CFTC	US Commodity Futures Trading Commission
CGFS	Committee on the Global Financial System
CICF	Collateral Initiatives Coordination Forum
CIF	ICMA Corporate Issuer Forum
CoCo	Contingent convertible
COGESI	Contact Group on Euro Securities Infrastructures
COREPER	Committee of Permanent Representatives (in the EU)
CPSS	Committee on Payments and Settlement Systems
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
CSDR	Central Securities Depository Regulation
DMO	Debt Management Office
D-SIBS	Domestic systemically important banks
EACH	European Association of CCP Clearing Houses
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Development
ECB	European Central Bank
ECJ	European Court of Justice
ECPC	ICMA Euro Commercial Paper Committee
ECOFIN	Economic and Financial Affairs Council (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Financial Stability Facility
EGMI	European Group on Market Infrastructures
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
EMTN	Euro Medium-Term Note
ERC	ICMA European Repo Council
ESA	European Supervisory Authority
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund
EURIBOR	Euro Interbank Offered Rate
Eurosystem	ECB and participating national central banks in the euro area
FASB	Financial Accounting Standards Board
FATCA	US Foreign Account Tax Compliance Act
FCA	UK Financial Conduct Authority
FIIF	ICMA Financial Institution Issuer Forum
FMI	Financial market infrastructure
FPC	UK Financial Policy Committee
FRN	Floating-rate note
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
FTT	Financial Transaction Tax
G20	Group of Twenty
GDP	Gross Domestic Product
GMRA	Global Master Repurchase Agreement
G-SIBs	Global systemically important banks
G-SIFIs	Global systemically important financial institutions
G-SIIs	Global systemically important insurers
HFT	High frequency trading
HMT	HM Treasury
IAIS	International Association of Insurance Supervisors
IASC	International Accounting Standards Board
ICMA	International Capital Market Association
ICSA	International Council of Securities Associations
ICSDs	International Central Securities Depositories
IFRS	International Financial Reporting Standards
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IRS	Interest rate swap
ISDA	International Swaps and Derivatives Association
ISLA	International Securities Lending Association
ITS	Implementing Technical Standards
KfW	Kreditanstalt für Wiederaufbau
KID	Key information document
LCR	Liquidity Coverage Ratio (or Requirement)
L&DC	ICMA Legal & Documentation Committee
LEI	Legal entity identifier
LIBOR	London Interbank Offered Rate
LTRO	Longer-Term Refinancing Operation
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MEP	Member of the European Parliament
MifID	Markets in Financial Instruments Directive
MifID II	Proposed revision of MiFID
MifIR	Proposed Markets in Financial Instruments Regulation
MMC	ECB Money Market Contact Group
MMF	Money market fund
MOU	Memorandum of Understanding
NAV	Net asset value
MTF	Multilateral Trading Facility
NCA	National Competent Authority
NSFR	Net Stable Funding Ratio (or Requirement)
OTC	Over-the-counter
OTF	Organised Trading Facility
OJ	Official Journal of the European Union
OMTs	Outright Monetary Transactions
PD	EU Prospectus Directive
PD II	Amended Prospectus Directive
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority
PRIPs	Packaged Retail Investment Products
PSI	Private Sector Involvement
PSIF	Public Sector Issuer Forum
QMV	Qualified majority voting
RFQ	Request for quote
RM	Regulated Market
RPC	ICMA Regulatory Policy Committee
RTS	Regulatory Technical Standards
SEC	US Securities and Exchange Commission
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SLL	Securities Law Legislation
SME	Small and medium-sized enterprise
SMPC	ICMA Secondary Market Practices Committee
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSM	Single Supervisory Mechanism
SSR	EU Short Selling Regulation
T+2	Trade date plus two working days
T2S	TARGET2-Securities
TD	EU Transparency Directive
TFEU	Treaty on the Functioning of the European Union
TRs	Trade repositories
UKLA	UK Listing Authority



ICMA welcomes feedback and comments on the issues raised in the Quarterly Report. 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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