ICMA
International Capital Market Association

# QUARTERLY REPORT

ASSESSMENT OF MARKET PRACTICE AND REGULATORY POLICY

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ICMA

International Capital Market Association

The mission of ICMA is to promote resilient and well-functioning international and globally integrated cross-border debt securities markets, which are essential to fund sustainable economic growth and development.

ICMA is a membership association, headquartered in Switzerland, committed to serving the needs of its wide range of members. These include public and private sector issuers, financial intermediaries, asset managers and other investors, capital market infrastructure providers, central banks, law firms and others worldwide. ICMA currently has 550 members located in 62 countries.

ICMA brings together members from all segments of the wholesale and retail debt securities markets, through regional and sectoral member committees, and focuses on a comprehensive range of market practice and regulatory issues which impact all aspects of international market functioning. ICMA prioritises four core areas – primary markets, secondary markets, repo and collateral markets, and the green and social bond markets.

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# Review of the year 2018 and outlook for 2019

*By Martin Scheck*

This has been an auspicious year for ICMA, the 50th since we were founded as the Association of International Bond Dealers, at the birth of the Eurobond market. Ever since, in all our various iterations, our mission has been to help the cross-border debt securities markets operate as effectively as possible, to help them intermediate capital flows across borders and to play a full role in facilitating growth and prosperity in the economy. Of course, we did not let this anniversary pass unnoticed and were pleased to welcome many eminent guests and members to a beautiful anniversary dinner at the Guildhall in London last February. We followed this with ICMA's 50th anniversary AGM and conference in Madrid - with a record attendance for the last two decades.

The core of our work is focused on day-to-day market practices in the debt capital markets and in dealing with the regulatory aspects in which these practices are embedded. Core areas of activity are the primary markets, secondary markets, repo and collateral markets and sustainability, in particular the green and social bond markets.

The year started with the MiFID II/MiFIR implementation on 3 January, the culmination of an enormous amount of work for the industry in 2017 and a regulation whose impact reaches far beyond the borders of the European Union. Has this vast and complex regulatory package achieved its objectives? Take a look at our recent study for our view. It is still early days but clearly the answer is "not yet" and there are unforeseen impacts which detract from the laudable objectives of the EU's Capital Markets Union, such as improving investor choice.

Aside from MiFID, there were plenty of other European regulations keeping us busy this year: (i) the implementation of the Prospectus Regulation is in full swing; (ii) the CSDR with its attendant proposal for mandatory buy-ins in the event of settlement fails (which we have long advocated against given its detrimental impact on liquidity and market making); and (iii) the vast task of implementing the Securities Financing Transaction Regulation, are just three of many. And whilst these are all European regulations, they all have extra-territorial impacts, so we have been working hard with our members outside Europe, in particular in Asia, to help them understand the implications for their business and processes.

Brexit and the interest rate benchmark transition project have developed into major ICMA workstreams this year requiring significant focus.

On Brexit, we have been particularly concerned about the impact of so-called "cliff-edge risks" which would arise in international capital markets when the UK leaves the EU either on 29 March 2019, if there is no agreement between the EU27 and the UK, or, if there is an agreement, at the end of the transition period. You may have seen ICMA's correspondence with the leaders of the EU27 and the UK on our concerns, their responses and our further comment and analysis. As we all know the situation on Brexit is very complex and political – of course ICMA as a Swiss association is totally apolitical but the politics will have an impact on how the markets will operate in future. Hence, we have been following closely and updating our members as extensively as we can.

The interest rate benchmark transition process, spurred by coordinated messages from the official sector primarily in the UK and the US, has developed enormous momentum in 2018. This is perhaps the most fundamental change to financial markets for many decades and impacts almost every user of financial products, both retail and wholesale. ICMA is extensively involved, from the perspective of the bond markets, with direct input to the various working groups in the UK, Switzerland and the rest of Europe and the US. Further information can be found in this Quarterly Report and on our website.

It is important that ICMA is well represented in important working groups providing input to the public sector authorities on behalf of our members. I am pleased to say this is the case, with membership amongst others in the relevant ECB outreach groups, the stakeholders' group of ESMA and expert groups of the European Commission.

This year has been notable for the increasing involvement of the official sector in the development of the green and social bond markets, one of ICMA's priorities. We run the Secretariat for the globally relevant Green and Social Bond Principles and in June held their first AGM outside Europe in Hong Kong with the support of the Hong Kong Monetary Authority (HKMA). We have also been working with the ASEAN regulators as they issue guidelines for social bonds following their 2017 green guidelines and have just held a highly successful Green Bond Conference in Tokyo with over 500 attendees. Back in Europe, in 2017 we were members of the European Commission's High-Level Expert Group which helped shape the EU's Action Plan on Sustainable Finance. Subsequently we were appointed to one of the highly sought-after seats on the Technical Expert Group and are now heavily involved in its work on EU standards and taxonomy.

ICMA is spending increasing time analysing market structure issues arising from electronification of processes and the application of new technologies. This is on the agenda of all our committees and we are unique in providing mappings of the many different FinTech solutions in the primary, secondary and repo markets on our website. We have been stepping up our interactions with regulators in Europe and Asia as they become more engaged in the topic.

It has been wonderful to see our membership continuing to grow again over the past year, as we add both buy-side and sell-side members from all over Europe and Asia. At 550 ICMA membership stands at the highest level for more than 20 years, which is very encouraging.

But of course, for ICMA what really counts is not the overall membership number but the quality and intensity of the engagement with our members.

Under our current model we have a relatively modest number of full-time employees and so our credibility and effectiveness depend critically on the participation of our members in the various product-specific and regional committees, councils and working groups that we run. Again, this has been at record levels this year, with well over 1,500 individual experts involved from our member firms.

Additionally, roundtables, conferences and calls provide an important medium for communication – as do our website, legal and regulatory helpdesk, quarterly reports, newsletters and social media presence. Usage statistics again reveal a markedly higher level of engagement this year.

We remain committed to providing high-quality executive education to market participants. Highlights in 2018 were the introduction of a green bond training course, delivered so far in the UK, Malaysia, Singapore, Hong Kong and Tokyo. We have also seen an upsurge in demand for in-house training. Our Chinese executive education joint venture continues to go well.

Operationally, the Association is in good shape with robust finances, meaning we will not need to increase fees for members in 2019. We are indebted to our committed, active and diverse Board of Directors for the guidance they provide and for generously devoting so much time to ICMA alongside their day-jobs. Notably this year the Board appointed the first ever female chair of ICMA in our 50-year history, Mandy DeFilippo.

I am also very grateful to our staff in Europe and Asia for all their efforts this year on behalf of our members. At times the workload has been immense.

For many of our members 2018 has been a challenging year as they navigate through the choppy waters of the financial markets buffeted by events beyond their control. It has seen the end of the ECB's huge quantitative easing programme, rising rates in the US, global trade tensions, market fragmentation, Brexit negotiations, and a difficult geopolitical situation. The outlook for the fixed income markets in 2019 is by no means clear. At ICMA most of the workstreams in which we are currently involved are multi-year projects and will continue. But undoubtedly other issues which affect our markets and our members' day-to-day business will arise, and we will need to remain nimble to address them and serve our members as well as we possibly can.

Last but not least, many thanks to you, our members, and to all those individuals who have worked with us this year, for your support. We wish you health and success in 2019.

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# Preparations for Brexit in international capital markets

By Paul Richards


## Summary

The purpose of this Quarterly Assessment is to provide an update for ICMA members on preparations for Brexit in international capital markets, with particular reference to cliff-edge risks in the event that the UK leaves the EU without an agreement. Brexit affects ICMA members in both the UK and the EU27, as well as more broadly.[1]


## The Withdrawal Treaty and Political Declaration

1 The British Government reached agreement with the EU27 at the European Council on 25 November 2018 on a Withdrawal Treaty and on a Political Declaration setting out the Framework for the Future EU27/UK Relationship, subject to ratification by both the British Parliament and the European Parliament. If an EU27/UK agreement is not approved and the necessary legislation not enacted before Article 50 expires on 29 March 2019, the default position is for the UK to leave the EU without an agreement, unless Article 50 is extended (which would require unanimous agreement by the EU27 on the basis of a proposal by the UK), or revoked (which would require a unilateral decision by the UK).[2]

2 The Withdrawal Treaty is accompanied by a Political Declaration setting out the Framework for the Future EU27/UK Relationship. Unlike the Withdrawal Treaty, the Political Declaration is not legally binding. It is intended to lay the groundwork for future negotiations during the transition period after Brexit.[3] The transition period after Brexit, which is covered in the Withdrawal Treaty, is due to last from Brexit on 29 March 2019 until the end of 2020. But it could be extended beyond the end of 2020 once for up to one or two further years, if the UK and the EU27 agree by 1 July 2020. During the transition period, the UK would effectively be subject to EU rules, but without any say in making them.

3 The Political Declaration covers financial services only briefly, and at a high level of generality:

- "The Parties are committed to preserving financial stability, market integrity, investor and consumer protection and fair competition, while respecting the Parties' regulatory and decision-making autonomy, and their ability to take equivalence decisions in their own interest. This is without prejudice to the Parties' ability to adopt or maintain any measure where necessary for prudential reasons. The Parties agree to engage in close cooperation on regulatory and supervisory matters in international bodies."
- "Noting that both Parties will have equivalence frameworks in place that allow them to declare a third country's regulatory and supervisory regimes equivalent for relevant purposes, the Parties should start assessing equivalence with respect to each other under these frameworks as soon as possible after the UK's withdrawal

1. See the Brexit webpage on the ICMA website for further background.

2. On 10 December, the European Court of Justice ruled that the UK can "unilaterally revoke" Article 50 before it expires.

3. The British Government calls the transition period an "implementation period".

from the Union, endeavouring to conclude these assessments before the end of June 2020. The Parties will keep their respective equivalence frameworks under review."

- "The Parties agree that close and structured cooperation on regulatory and supervisory matters is in their mutual interest. This cooperation should be grounded in the economic partnership and based on the principles of regulatory autonomy, transparency and stability. It should include transparency and appropriate consultation in the process of adoption, suspension and withdrawal of equivalence decisions, information exchange and consultation on regulatory initiatives and other issues of mutual interest, at both political and technical levels."[4]

## Cliff-edge risks in international capital markets

4 In preparing for Brexit, our focus at ICMA has been on addressing and avoiding cliff-edge risks in international capital markets. Cliff-edge risks will arise when passporting rights between the EU27 and the UK cease: most immediately, if the UK leaves the EU without an agreement on 29 March 2019; but cliff-edge risks will also arise, even if there is an agreement, at the end of the transition period. The key difference is that, if there is a transition period after Brexit, that will give market firms more time to prepare.

5 With the support of the ICMA Board, ICMA wrote an open letter to senior political leaders in the EU27 and the UK in June 2018 about cliff-edge risks in international capital markets. There was a detailed response from Valdis Dombrovskis, the Vice-President of the European Commission, in July and from the UK City Minister, John Glen, in August. An ICMA paper on cliff-edge risks in international capital markets was published in the ICMA Quarterly Report for the Fourth Quarter on 11 October.

6 The ICMA paper can be summarised as follows:

- The UK is proposing to leave the EU Single Market in financial services when it leaves the EU. Cliff-edge risks will arise when passporting rights between the EU27 and the UK cease (ie most immediately if the UK leaves the EU on 29 March 2019 without an agreement, with the result that there is no transition period).
- The UK originally proposed to the EU27 that there should be mutual market access when passporting rights cease. This approach was rejected by the EU27.
- One alternative for market firms in the UK is to make use of EU provisions on regulatory equivalence for third countries. This is currently a patchwork, though it may be possible for the UK to negotiate enhancements after Brexit.
- If it is not possible to rely solely on regulatory equivalence, the other option is for market firms to ensure that, before passporting rights cease, they are authorised to operate both in the EU27 and in the UK.
- It appears that, when passporting rights cease, firms will in general be able to carry out contractual obligations already agreed between EU27 and UK entities on cross-border financial contracts. But specific cliff-edge risks will still arise when passporting rights cease.
- In the paper, we listed examples of specific cliff-edge risks relating, among others, to: CCPs; OTC derivative contracts; delegation of fund management; and data exchange.

7 We argued that the best way of avoiding these specific cliff-edge risks would be by agreement between the EU27 and the UK, and that agreement should be reached as soon as possible:

- In the UK, a Temporary Permissions Regime (TPR) is being introduced for a limited period after Brexit, in the event that the UK leaves the EU without an agreement, with the result that there is no transition period. This "will allow inbound firms to continue operating in the UK within the scope of their current permissions for a limited period, while seeking full UK authorisation. It will also allow funds with a passport to continue temporarily marketing in the UK."[5]
- In the EU27, there has so far been no equivalent to the TPR. However, on 13 November, the European Commission stated that it "will act, to the extent necessary, to address financial stability risks in the EU arising from the withdrawal of the UK without any agreement". And on 19 December, the Commission concluded that "only a limited number of contingency measures is necessary to safeguard financial stability in the EU27. These measures mitigate financial stability risks only in those areas where preparedness actions from market operators alone are clearly insufficient to address these risks by the withdrawal date."[6]

8 In the period running up to the end of 2018, progress was made in addressing some of the specific cliff-edge risks in international capital markets which will arise, if there is no EU27/UK agreement on Brexit. The extracts that follow are taken from relevant statements by the Bank of England and

4. Political Declaration setting out the Framework for the Future Relationship between the EU and the UK, paragraphs 37-39.

5. FCA, *Preparing Your Firm for Brexit,* FCA website. The UK is also proposing Temporary Recognition Regimes for CCPs, CSDs, credit rating agencies, trade repositories and data reporting service providers, among others.

6. European Commission: *Preparing for the Withdrawal of the UK from the EU on 30 March 2019: Implementing the Commission's Contingency Action Plan,* 19 December 2018. Other Commission quotes are from the same source or its earlier statement on 13 November 2018.

the FCA in the UK, and by the ECB, the European Commission and ESMA in the EU27, with particular reference to the risk of a "no-deal" Brexit:

## Legal framework

9 There is now only a short time for enacting the relevant legislation in the UK for Brexit. The FCA has stated that, on Brexit: "EU legislation would cease to apply in the UK. Instead, the relevant legislation would be converted into UK law through the EU (Withdrawal) Act and amended by Government and regulators to ensure the UK continues to have a functioning regulatory regime. The Government has also proposed to provide the FCA and Bank of England with powers to smooth the transition to the new regime. In the event the UK leaves the EU with no agreement, it will be crucial that all the relevant statutory instruments intended to be laid by Government are in place by exit."[7]

10 The Bank of England has stated: "The EU (Withdrawal) Act has come into force. HM Treasury plans to take forward around 60 pieces of secondary legislation for financial services before March. Sixteen statutory instruments are particularly important to mitigate risks of disruption to users of financial services. As of 26 November, four of these have become law, including the temporary regimes to allow EU banks, insurers and CCPs to serve UK customers. Timelines remain tight to take forward the remaining secondary legislation."[8]

## CCPs and CSDs

11 The ECB has stated: "Cross-border clearing of derivatives contracts is one area where financial stability risks may arise in a cliff-edge Brexit scenario without sufficient mitigating actions. If UK CCPs become non-recognised third country entities after March 2019, euro area clearing members of UK CCPs will be exposed to legal risks if they continue to use UK CCPs to clear both new and existing trades."[9]

12 On 13 November, the European Commission stated that "it will adopt a temporary and conditional equivalence decision in order to ensure that there will be no disruption to central clearing." On 23 November, ESMA stated that it "is engaging with the European Commission to plan, as far as possible, the preparatory actions for the recognition process of UK CCPs, in case of a no-deal scenario. ESMA has already started engaging with UK CCPs to carry out preparatory work. The aim is to ensure continued access to UK CCPs for EU clearing members and trading venues as of 30 March 2019, should all the conditions in EMIR, including any conditions set out in the equivalence decision, be fulfilled."

13 In response to the European Commission, the ECB stated: "These potential risks have now been addressed through the assurance provided by the European Commission that, if necessary, it will allow EU firms to continue to clear derivatives contracts with UK-domiciled CCPs, under strict conditionality and with limited duration." The Bank of England Financial Policy Committee also welcomed "the European Commission's recent statement that it is willing to act to ensure that EU counterparties can continue to clear derivatives at UK central counterparties (CCPs) after March 2019."

14 However, the Bank of England also stated: "Without greater clarity on the scope, conditions and timing of the prospective EU action, CCPs and their members could not determine whether the Commission's proposal fully removed the legal risks they face. As a result the derivatives contracts EU clearing members had cleared with UK CCPs would need to be closed out or transferred by the end of March 2019. That process would be necessary to ensure the safe operation of UK CCPs beyond that date. It would need to begin in December 2018 in order to mitigate the risk of material market disruption and respect CCP rulebooks."[10]

15 On 19 December, the European Commission adopted "a temporary and conditional equivalence decision for 12 months [from the withdrawal date if the Withdrawal Agreement is not ratified] to ensure that there will be no disruption in central clearing of derivatives. This will allow ESMA to recognise temporarily central counterparties currently established in the UK, allowing them temporarily to continue providing services in the EU. The Commission has concluded that EU27 companies need this time to have in place fully viable alternatives to UK operators." In parallel, ESMA published a statement to clarify its plans for the recognition of CCPs established in the UK as third country CCPs under EMIR, in the event of a no-deal Brexit, when the CCPs would become third country CCPs.[11]

16 In addition, the European Commission adopted "a temporary and conditional equivalence decision for 24 months to ensure that there will be no disruption in

7. FCA: *EU Withdrawal Impact Assessment*, November 2018. Other FCA quotes are from the same source.

8. Bank of England Financial Stability Report, 28 November 2018. Other Bank of England quotes are from the same source or from the record of the Financial Policy Committee published on 5 December 2018, except where otherwise noted.

9. ECB Financial Stability Review, 29 November 2018. Other ECB quotes are from the same source.

10. On 7 December 2018, ICMA, AFME, FIA and ISDA wrote to Commissioner Dombrovskis seeking further clarification on the Commission's statement regarding temporary equivalence for the purpose of recognition for UK CCPs.

11. ESMA is ready to review UK CCPs' and CSDs' recognition applications for a no-deal Brexit scenario, 19 December 2018.

services provided by UK central securities depositories. It will temporarily allow them to continue providing notary and central maintenance services to operators in the EU. This will allow EU27 operators that currently have no immediately available alternative in the EU27 to fulfil their obligations under EU law." ESMA also stated that it will follow a similar process for the recognition of the UK CSD as a third country CSD under CSDR, as planned for UK CCPs.[12]

17 On 19 December, the Bank of England published a statement, saying that the Bank "welcomes the adoption today of temporary equivalence decisions by the European Commission on the future UK legal and supervisory framework for CCPs and CSDs." The Bank also said: "Today's announcement is a crucial and positive step. It provides necessary clarity and addresses one of the most important financial stability risks associated with the UK's withdrawal from the EU. It also enables UK CSDs to be recognised so that they can continue providing notary and settlement services for securities issued under EU law."[13]

## OTC derivative contracts

18 The Bank of England has stated: "In the absence of action, certain lifecycle events cannot be performed on cross-border derivative contracts after Brexit. The UK Government has legislated to ensure that these lifecycle events can continue to be performed after Brexit on derivative contracts that UK clients (such as non-financial companies) have with UK banks. However, national rules in some EU Member States may prevent UK clients and banks from performing certain lifecycle events on derivative contracts that they have with UK banks."

19 The ECB has stated: "The continuity of servicing uncleared cross-border derivatives contracts is unlikely to pose significant risks to financial stability provided that the private sector takes sufficient action. The performance of certain lifecycle events and the exercise of certain options are, however, subject to authorisation in certain euro area countries. But the private sector can take a range of actions to mitigate risks associated with no longer being able to carry out lifecycle events on the affected contracts: These include: (i) trading-related strategies including bilateral novations; (ii) holding contracts to maturity and using other mechanisms with non-UK counterparties to adjust hedges; (iii) early terminations; (iv) actions based on statutory schemes for the collective transfer of business to the EU27; or (v) pursuing authorisations based on EU national regimes designed to enable the cross-border provision of services from a third country." The ECB also noted that ESMA "has proposed regulatory technical standards in order to facilitate the novation of certain non-centrally cleared OTC derivatives contracts to EU counterparties during a specific time window, in case of a no deal scenario."

20 On 19 December, the European Commission adopted two Delegated Regulations [that will apply from the withdrawal date if the Withdrawal Agreement is not ratified], facilitating novation, for a fixed period, of certain OTC derivatives contracts with a counterparty established in the UK to replace that counterparty with a counterparty established in the EU. This allows such contracts to be transferred to an EU counterparty while maintaining their exempted status and thus not becoming subject to clearing and margining obligations under EMIR. Such contracts, pre-dating EMIR, are exempted from EMIR requirements. This act will ensure that a change of counterparty will not change that exempted status."

## Insurance contracts

21 The ECB has stated: "Financial stability risks are not expected in the area of cross-border insurance contracts. UK insurance undertakings will lose their authorisation to conduct business in the euro area (and vice versa) in a cliff-edge scenario. But UK insurance companies servicing euro area policyholders have a number of options available to them to mitigate any disruption. These include portfolio transfer, establishment of a third country branch, relocation of a European company (Societas Europaea) or termination of contracts. These options are being actively used by firms. The vast majority of outstanding cross-border insurance contacts are covered by credible contingency plans, with the residual contracts primarily pertaining to non-life insurers."

## Fund management

22 The Bank of England has stated: "The UK Government has legislated for EU asset management firms to continue operating in the UK after exit. Further legislation will provide a temporary permissions regime for EU investment funds to continue marketing in the UK." It has also stated: "EU rules allow asset managers to delegate the management of their assets to entities outside the EEA when a cooperation agreement is in place between the authorities. The European Commission has publicly encouraged ESAs to prepare such agreements with the UK. In the absence of a cooperation agreement, there is a risk of changes to asset managers' businesses that could be disruptive." And the FCA has stated: "Asset managers

12. ESMA plans to allow the UK CSD to continue to service Irish securities.

13. Bank of England statement on equivalence of the future UK legal and supervisory framework for CCPs and CSDs, 19 December 2018.

are dependent on cooperation agreements between the FCA and national competent authorities being in place to continue to manage portfolios for EU clients and funds."

## Supervision and enforcement

23 On 3 October, the Chair of ESMA proposed to start negotiations with the UK FCA on MOUs, which "are essential to meet our regulatory objectives and allow information exchange for effective supervision and enforcement."[14] The European Commission has also encouraged the ESAs to begin preparing MOUs with UK supervisors to ensure all parties can exchange information immediately from exit. The aim here is to ensure that exchange of information about financial institutions and participants is possible immediately after the withdrawal date if there is no deal.

## Data exchange

24 The ECB has stated: "Potential disruptions to personal data flows should be negligible as financial institutions are advanced in their planning and intend to rely on mechanisms available to them under the data protection legal framework, such as for example standard contractual clauses."

25 The Bank of England has stated: "The UK Government has announced its intention to continue to allow the free flow of personal data from the UK to the EU. Once in effect, this will reduce disruption to UK households and businesses' use of EU financial service providers." "The European Commission has indicated that it does not intend to take similar action to ensure the free flow of personal data from the EU to the UK in a no-deal scenario. This may restrict EU households and businesses from continuing to access UK financial service providers." The FCA has also stated: "Without action by EU authorities EU rules would limit the flow of personal data from the EU to the UK."

## MREL

26 The ECB has stated: "Some uncertainty remains over the treatment of the stock of MREL securities issued under UK law, in the event that the UK decides not to recognise the resolution powers of the Single Resolution Board (SRB)." The ECB has added: "A mitigating factor for MREL shortfall risk is the case-by-case approach that would be taken by the SRB, which may entail extending the affected banks' transitional periods to meet MREL requirements. The UK could also solve the issue by unilaterally recognising the resolution actions of the SRB, and thus continuing to comply with the Key Attributes of Effective Resolution Regimes for Financial institutions developed by the Financial Stability Board."

## Other risks

27 The Bank of England Financial Policy Committee has drawn attention to a range of other risks that could cause some, albeit less material, disruption to economic activity if they are not mitigated, including risks relating to "credit rating agencies, settlement finality protection for financial market infrastructure, UK banks' access to euro payment systems, the ability of EU firms to trade on UK trading venues and increased prudential requirements for banks and insurance companies."

28 In its Q&A on its Communication of 19 December, the Commission stated: "As indicated by the Commission in the Communication of 13 November, contingency measures shall be strictly limited to what is necessary to deal with major disruptions. They cannot offset some of the costs created by the application of two separate regulatory and supervisory frameworks, nor remedy delays that could have been avoided by preparedness measures and timely action by relevant operators."

## Conclusion

29 The ECB has stated: "An orderly withdrawal of the UK from the EU poses a limited overall risk to euro area financial stability. But the uncertainty accompanying a cliff-edge Brexit could have the potential to pose a more significant downside risk to financial stability." The Bank of England has stated: "Since the EU referendum in 2016 the Financial Policy Committee and other authorities have identified risks of disruption to the financial system that could arise from Brexit and worked to ensure they are addressed."

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14. Steven Maijoor, Chair of ESMA: speech in Athens, 3 October 2018.

# The transition from LIBOR to risk-free rates

By Paul Richards


## Summary

RFR

This paper assesses progress in the transition from LIBOR to risk-free rates, with a particular focus on the transition in the international bond market: the adoption of risk-free rates in floating rate notes, securitisations and capital securities; the risks arising from new bond issues still referencing LIBOR; the feasibility of converting legacy bonds to risk-free rates; international coordination between different jurisdictions; and raising market awareness of the need to prepare for the transition to risk-free rates.[1]


## Background

1 In July 2017, Andrew Bailey, the Chief Executive of the UK Financial Conduct Authority, said that the FCA would no longer intend to persuade or compel banks to submit contributions for LIBOR after the end of 2021, and he stressed the need to transition away from LIBOR before the end of 2021.[2]

2 When he spoke again about LIBOR at Bloomberg in London on 12 July 2018, Andrew Bailey said that the importance of transitioning away from LIBOR had not changed; discontinuation of LIBOR should not be considered a remote event; firms should treat it as something that will happen and which they must be prepared for. In conclusion, he said: "For firms who are not yet aware, not yet engaged, and without plans to address their LIBOR-related dependencies, I warn you again of the risks."[3]

3 Following Andrew Bailey's speech, In September 2018 the UK FCA and PRA wrote to the chief executives of banks and insurance companies that they supervise in the UK, asking them to provide details of their preparations to manage risks inherent in the transition from LIBOR to alternative interest rate benchmarks.

4 In the view of the authorities,[4] the problem with LIBOR can be summarised as follows:

- First, since the financial crisis, the underlying structure of financial markets has changed: LIBOR really has become the rate at which banks do *not* lend to each other.
- Second, LIBOR is a risk to financial stability: the pricing of hundreds of trillions of dollars of financial instruments rests on the expert judgment of relatively few individuals, informed by a very small base of unsecured interbank transactions.
- And third, in the period before the introduction of benchmarks regulation, there was more scope for LIBOR to be manipulated.

1. For more background, see the webpage on interest rate benchmark reform and the transition to risk-free rates on the ICMA website.

2. Andrew Bailey, Chief Executive of the FCA: *The Future of LIBOR*, 27 July 2017.

3. Andrew Bailey, Chief Executive of the FCA: *Interest Rate Benchmark Reform: Transition to a World Without* LIBOR, 12 July 2018.

4. See in particular the speeches by the Governor of the Bank of England and the President of the Federal Reserve Bank of New York at the Bank of England Markets Forum, 24 May 2018; and the speech by the Chair of ESMA at the ICMA Annual Conference in Madrid, 31 May 2018.

5 To avoid the problems associated with manipulation of LIBOR in the past and the financial stability risks arising from LIBOR in the future, the authorities want financial markets to transition away from LIBOR to near risk-free rates. In all the main jurisdictions, the chosen risk-free rates are overnight rates: SONIA in the UK; SOFR in the US; ESTER in the euro area; SARON in Switzerland; and TONA in Japan. A common objective is to make risk-free rates as robust as possible, with robustness measured primarily by the volume of underlying observable transactions.

## The transition in the international bond market

6 The transition from LIBOR to risk-free rates is a major challenge, bearing in mind the risk of market disruption and litigation. It will only succeed if the authorities and market participants work together. To help organise the transition from LIBOR to risk-free rates, the authorities have set up a series of working groups involving market participants in each jurisdiction. In the UK, following a period in which only derivatives experts were involved, the Bank of England and the FCA decided in late 2017 to involve the cash markets (ie bonds and loans). ICMA is now involved in the working groups in the UK, the euro area and in Switzerland, and chairing the Bond Market Sub-Group in the UK, working closely with the FCA and the Bank of England.

7 The five key questions on which ICMA is engaged in the international bond market relate to: the adoption of risk-free rates in floating rate notes, securitisations and capital securities; the risks arising from new bond issues still referencing LIBOR; the feasibility of converting legacy bonds to risk-free rates; international coordination between different jurisdictions; and raising market awareness of the need to prepare for the transition to risk-free rates.

## The adoption of risk-free rates in the bond market

8 The first question relates to the adoption of risk-free rates in new bond issues. There are two main options, which are not mutually exclusive, as the market could be offered a choice:

- One option is to replace term LIBOR with a backward-looking risk-free rate. For example, interest on the risk-free rate could be compounded daily in arrears over each interest period. That was the case with a new EIB five-year floating rate note referencing SONIA, which was successfully launched at the end of June. Overall, there were 13 new FRNs referencing SONIA in the second half of 2018 with a total value of nearly GBP 7 billion, all using the same market conventions as the EIB issue and based on UK practice; and the first SONIA-linked residential mortgage-backed securitisation with a value over GBP 7 billion was issued in December. There were also a number of FRNs in the US referencing SOFR, starting with Fannie Mae and the World Bank, and using slightly different market conventions based on US practice.[5] As risk-free rates are overnight rates, which have the largest volume of underlying observable transactions, backward-looking rates are the most robust, on the basis described in the statement by the Financial Stability Board in July 2018.[6] But interest payments are not known at the start of the interest period.
- Another hypothetical option is to replace term LIBOR in new bond market transactions with a forward-looking term rate derived from the risk-free rate. With a forward-looking term rate, floating rate interest payments would be known in advance, as they are with LIBOR. But forward-looking rates are not as robust as backward-looking rates, as forward-looking rates are derived from risk-free rates, rather than referencing risk-free rates directly themselves, and have a lower volume of underlying observable transactions.[7] In July 2018, the Sterling RFR Working Group published a consultation paper on forward-looking term rates. Following the deadline for responses, the Bank of England published in November 2018 a summary of responses on behalf of the Sterling Risk-Free Rate Working Group. (See box.)[8]

5. The main differences are between compounding over the interest period in the UK and averaging in the US; and between interest payment "lags" in the UK and "lockouts" in the US. But an EIB SOFR transaction in early December used compounding rather than averaging.

6. "The RFRs are based on overnight trades in markets, whether unsecured or secured, where liquidity is deep enough to allow the rate to be strongly anchored in transactions, including in more adverse market conditions. To the extent that overnight RFRs are more strongly rooted in transactions than alternative measures, they represent the most robust alternatives available to the market. The RFRs, by largely excluding bank credit risk, also closely track central bank policy rates, offering a more efficient and transparent way of measuring, managing, and hedging movements in those rates.": FSB: *Interest Rate Benchmark Reform – Overnight Risk-Free Rates and Term Rates,* 12 July 2018.

7. "The FSB does not expect such RFR-derived term rates to be as robust as the RFRs themselves, and they should be used only where necessary.": FSB, *op.cit*.

8. The Bank of England also published a *Next Steps* document in December 2018 on behalf of the Sterling RFR Working Group, which invites interested benchmark administrators to consider the summary of responses to the consultation, and to share any views on the development of term SONIA reference rates, by 15 February 2019.

### Sterling RFR Working Group Consultation on Term SONIA Reference Rates: summary of responses

Key takeaways from the 45 responses to the consultation have been summarised by the Bank of England as follows:

"A Term SONIA Reference Rate (TSRR) would facilitate the transition for some cash market segments.

Current SONIA-referencing derivatives markets were seen as capable of providing the basis for a TSRR, but would need a step change before such a measure would be sufficiently robust.

An alternative way forward could be to use a consistent methodology with inputs from both futures contracts and OIS swaps contracts.

Building a robust TSRR would benefit from further development and growth in OIS and SONIA futures markets.

Compliance with IOSCO principles is necessary, including appropriate governance and controls, to ensure risks related to TSRR production are appropriately managed.

Finding ways to avoid the systematic usage of TSRRs in derivatives markets will be essential as TSRRs develop.

International consistency across currencies was viewed as desirable."

## The risks arising from new bond issues referencing LIBOR

9 The second question is how to avoid the risks arising from new bond issues referencing LIBOR and maturing beyond 2021, when LIBOR may no longer be available. The most effective way of avoiding risks related to the discontinuation of LIBOR is for new bond issues to reference risk-free rates. In the UK since the EIB bond issue referencing SONIA in June, there has been some success in encouraging the issue of bonds referencing SONIA rather than LIBOR. But some issuers and investors are not yet able to use SONIA: for example, some have not yet completed the adjustment of their IT systems; and some may be waiting for a term SONIA reference rate, which has not yet been developed. In those cases, they need to be aware of the risks of continuing to issue new bonds referencing LIBOR. In July, the Sterling Risk-Free Rate Working Group published a paper on the risks of issuing new sterling bonds referencing LIBOR for maturities beyond 2021, when LIBOR may no longer be available, and ways of mitigating those risks.[9]

10 One possible way of mitigating the risks of LIBOR discontinuation is for any new bond issues referencing LIBOR to include robust fallbacks, which are now required for supervised entities under the EU Benchmarks Regulation (BMR). However, many legacy bonds referencing LIBOR fall back to a fixed rate. These fallbacks were originally designed in case LIBOR becomes temporarily unavailable. Falling back to a fixed rate may not be commercially acceptable to issuers or investors, if LIBOR becomes unavailable permanently. Since the FCA's statement in July 2017, new fallbacks have been introduced in new LIBOR bonds, though it is not always clear how they will operate in the event of LIBOR discontinuation.

11 There are two recent consultations involving fallbacks, with global implications:

- In the US, the Alternative Reference Rate Committee (ARRC) published a consultation paper on a proposal to introduce new fallbacks to risk-free rates in new FRN transactions referencing US dollar LIBOR, covering: the triggers for the fallback to risk-free rates; a waterfall for the choice of replacement benchmarks; and a waterfall for the equivalence spread between LIBOR (which includes bank credit risk) and the relevant replacement benchmark such as SOFR (which, as a risk-free rate, does not include bank credit risk). The choice of some of the key steps down the waterfalls depends on official endorsement by a body such as the ARRC. The deadline for responses was in November 2018.[10]
- In addition, ISDA consulted the sterling market, and some other markets, on new fallbacks to risk-free rates in the derivatives market referencing LIBOR, in the event that LIBOR is no longer available.[11] The final results were published by ISDA in December 2018. (See box.)

9. Sterling RFR Working Group: *New Issuance of Sterling Bonds Referencing LIBOR,* July 2018. This paper is available on the Bank of England website.

10. The ARRC has also published consultation papers on fallbacks in new loan and securitisation transactions.

11. The consultation related to GBP LIBOR, CHF LIBOR, JPY LIBOR, TIBOR, Euroyen TIBOR and BBSW. ISDA received 152 responses from 164 entities.

### *ISDA Consultation on Fallbacks for Derivatives Referencing LIBOR: final results*

"The overwhelming majority of respondents preferred the "compounded setting in arrears rate for the adjusted risk-free rate" (RFR), and a significant majority across different types of market participants preferred the "historical mean/median approach" for the spread adjustment. The majority of respondents preferred to use the same adjusted RFR and spread adjustment across all benchmarks covered by the consultation, and potentially other benchmarks (such as US dollar LIBOR, euro LIBOR and EURIBOR).

In accordance with these results, ISDA will proceed with developing fallbacks for inclusion in its standard definitions based on the compounded setting in arrears rate and the historical mean/median approach to the spread adjustment for all of the benchmarks covered by the consultation. In the coming months, ISDA and its independent advisors will work to determine the appropriate parameters for the historical mean/median approach to the spread adjustment (including, for example, whether to use a mean or median calculation and the length of the historical lookback period)."

12 It is sometimes argued that the introduction of robust fallbacks for new bond market transactions referencing LIBOR may reduce the incentive to transition to risk-free rates. However, the BMR requires supervised entities to have robust fallbacks; and it is also preferable for fallbacks to be robust because, if they are not robust, the number of legacy bonds referencing LIBOR without robust fallbacks will continue to increase. In conclusion, promoting new issues referencing risk-free rates and ensuring that any new issues referencing LIBOR have robust fallbacks both help to cap the size of the legacy problem. But they do not solve it.

## The feasibility of converting legacy bonds

13 So the third question concerns the feasibility of converting legacy bonds referencing LIBOR to risk-free rates, if LIBOR ceases to be available. Conversion from LIBOR to a risk-free rate like SONIA would be more complex in the bond market than in the derivatives market: protocols, which are used in the derivatives market, cannot be used to amend bond market contracts; amending the terms of bond contracts requires bondholder consent, the threshold for which is generally set at a high level. In addition, LIBOR and SONIA are economically not the same, and so conversion from one to the other could be expected to require an adjustment spread.

14 There is less of a problem with short-dated legacy bond issues, which will mature while LIBOR continues to be available, as long as they can continue to be hedged effectively in the meantime. But there is much more of a problem in the case of longer-dated bond issues. It has been estimated that at least the equivalent of $864 billion bonds referencing LIBOR is currently outstanding and due to mature beyond 2021, of which at least the equivalent of $78 billion is referenced to sterling LIBOR, and these figures exclude some issues and issuers, such as sovereigns.[12] The Sterling RFR Working Group's Bond Market Sub-Group in the UK is considering the options for the conversion of legacy bonds referencing LIBOR with traditional fallbacks and consent thresholds.

## The need for international coordination

15 The fourth question relates to the need for coordination between the bond, loan and derivatives markets and between different IBOR jurisdictions globally. Work at global level is coordinated by the Official Sector Steering Group (OSSG), set up by the Financial Stability Board. The FSB OSSG is co-chaired by Andrew Bailey, Chief Executive of the FCA, and Jerome Powell, the Chair of the Federal Reserve Board, and consists of the benchmark authorities around the world. At its meeting in London on 4 June, the FSB OSSG held a session with trade associations, including ICMA, focusing both on the importance of global coordination and on the need in the bond and loan markets to provide forward-looking term rates as well as backward-looking rates. The FSB OSSG published a statement on 12 July to coincide with Andrew Bailey's speech at Bloomberg.[13]

16 On international coordination, there are two points to emphasise:

- One is that there are of course some differences between the five main IBOR jurisdictions – the UK, the US, the euro area, Switzerland and Japan – both as regards the timing of the transition to risk-free rates, and as regards the approach to the transition, so as to take account of local circumstances: for example, whether risk-free rates

12. Source: Royal Bank of Canada Capital Markets.

13. FSB: *Interest Rate Benchmark Reform – Overnight Risk-Free Rates and Term Rates*, 12 July 2018.

are secured or unsecured. But the question is how much these differences matter, as the underlying direction of travel in all jurisdictions is the same.

- The other point to emphasise is that, in addition to coordination between the authorities, there needs to be close market coordination internationally: not just between the bond market, the loan market and the derivatives market in each individual jurisdiction, but between market participants in the different jurisdictions.

## The need to raise market awareness

17 The final question is how to raise awareness in the market of the need to prepare for the transition to risk-free rates. While the level of awareness of the proposed transition to risk-free rates has grown, market preparations are still at an early stage, particularly – though not only – in the cash markets.

- The authorities themselves play an important role in raising market awareness: for example, through official speeches; through involvement in working groups and events; and, in the UK case, through letters from supervisors to chief executives of supervised firms to encourage them to prepare.
- Trade associations like ICMA can also help. For example:
    - At the 50th ICMA AGM and Conference in Madrid at the end of May 2018, ICMA arranged a panel of senior officials representing the Bank of England, the FCA, the European Central Bank, the Federal Reserve in the US and the Swiss National Bank to explain to ICMA members why the transition to risk-free rates is important, and to discuss what market firms need to do to prepare.
    - ICMA provides updates on the transition to risk-free rates in the ICMA Quarterly Report and holds conference calls for ICMA members.
    - ICMA also has a specific webpage on the ICMA website dedicated to information about interest rate benchmark reform and the transition to risk-free rates.
- And finally, individual market firms have an important role to play, not only in becoming well prepared for the transition to risk-free rates themselves, but also in helping their clients to do the same.

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# Restoring trust in financial services

*By Andreas Utermann*

It has become accepted wisdom that the Great Financial Crisis of 2008 led to a profound breakdown in trust in financial services, which – ten years on – has proved hard to bring back. Much has been said about the damage caused by a few bad apples, for which we are all paying the reputational price.

However, we may be overstating the degree to which trust existed in the years before the crisis, and understating the extent to which the industry needs to look beyond conduct and behaviours to re-establish the lasting trust of policy makers and the public at large.

I would like to consider:

- the importance of trust in a market economy;
- what Brexit tells us about breakdowns in trust;
- the role of diversity and inclusion in rebuilding trust;
- the need to promote financial literacy;
- why tackling fees has to be on the menu; and
- what we should be doing to deliver sustainable value to clients.

## The importance of trust in a market economy

In today's advanced, complex and global economies, the degree of trust required to operate efficiently is extraordinary:

- governments rely on us to fund infrastructure programmes;
- regulators rely on us to fulfil our fiduciary responsibilities;
- individuals rely on us to manage their hard-earned savings responsibly and deliver good value; and
- society relies on us to facilitate efficient capital allocation to fund economic growth.

There can be no doubt that the financial crisis has eroded confidence and trust that we will fulfil these expectations.

Our industry has been accused of unfairly benefitting at the expense of clients, of operating with a general lack of transparency, of taking advantage of conflicts of interest, and generally making money by abusing our position of power and information. As a result, our governance and actions are under unprecedented scrutiny.

I am a firm believer that trust is a structural condition necessary to support all effective human interactions, including those that drive investment. Breaking trust means therefore breaking a foundational structure of behaviour, that leads potentially to irrational actions in search of protection or safety. To re-establish lost trust, we will have to manage expectations more closely, and more accurately (and in so doing accept that we have failed to prove our case as an industry over the last decades).

We must demonstrate professionalism by being fully transparent with our clients, delivering the message that we are a force for growth and for good:

- we need to do a better job of explaining ourselves and justifying our fees;
- we need to prove our value and our ability to deliver on our mission and our fiduciary duty;
- we need to meet the expectations of clients in order to be able to keep our promises, count on clients' trust through ups and downs; and
- we need to be representative of the message we are sending, in terms of diversity and inclusion, in terms of governance and internal policies.

## Brexit and the breakdown of trust

To see what a breakdown in trust looks like, we need look no further than the United Kingdom's referendum on membership of the EU. The result of that plebiscite is quite remarkable on many levels, not least because it went against the recommendation of the Government and Opposition parties in Parliament. The result itself was an expression of distrust in the Establishment and the *status quo*.

For those of us in financial services, we are all, to varying degrees, caught up in the uncertainty surrounding Brexit and the implications it may have for Europe's capital markets. We have a duty to our clients and the public to be clear about operational planning and our assessment of the issues associated with Brexit.

## The role of diversity and inclusion in rebuilding trust

Another topic of societal importance which is critical to building trust in financial services is diversity and inclusion. Across financial services we have spoken about the need to develop our workforces to reflect better the societies we serve. The reality on the ground and in our firms has not yet caught up with the talk, though.

When we look at the asset management industry, a multi-pronged approach is needed:

- establishing a more rounded graduate intake is relatively straightforward, but this represents a small portion of the workforce;
- establishing an inclusive culture – one where unconscious biases are challenged and where colleagues are developed on potential, and rewarded and promoted on merit – will be integral to achieving and sustaining success; and
- an inclusive culture is one that is more likely to be trusted.

## Financial literacy is a long-term project to build understanding

Another long-term initiative that will help to establish trust is financial literacy. Promoting greater financial literacy is something financial services firms – asset managers included – should be engaged in, because financial literacy has arguably never been more important.

Over the last two or three decades, financial risk for one's future has shifted from employer and state towards the individual. This is a trend that is set to continue. But individuals – at least too many of them – are ill-equipped to navigate a dizzying array of choices, one seemingly more complex than the next.

This leads to the growing importance of financial advice and wealth management, but the additional layers of intermediation do not bring down cost and still leave the individual with the question: *Who do you trust?*

Too much money is not being put to use through lack of trust. The more people we can educate on financial literacy, the more we can increase individuals' confidence to engage on their future needs and ask the right questions of financial services providers, so that they are able to distinguish the different offerings and client value propositions.

## Tackling fees has to be on the menu

The perception of investment fees – in particular fees relative to outcome – is a thorny topic. Part of the issue is that they come in so many different forms.

It was reassuring to see that the asset management industry got to the right place on broker research costs. While there is more work to be done on the pricing of research, it is the right long-term answer for us to build this into our costs and management fee.

Another area that we need to give much more attention to when we consider the future of active management is performance fees. This is not because they will make life simpler for investors or distributors to predict a fee, but because they have the potential to transform the experience for clients.

There is also no getting away from the fact that the "price of beta" has been compressed significantly with the broad availability of index ETFs and other beta products – only some active managers have responded to that particular challenge by readjusting their pricing models.

Tightly aligning the interests of investment managers with clients will create the opportunity to change the conversation, from one which is pro-cyclical where no-one owns the performance, to one that is counter-cyclical so that there is a real long-term partnership based on creating and sharing value together.

In this context, we can also demonstrate the value we can and do bring as active stewards of capital and supporting sustainability through important extra-financial considerations such as ESG.

## To sum up

For those of us who operate in financial markets every day on behalf of our clients, we should welcome initiatives and measures that help to build trust structurally and for the long term – as this will be the only way to fulfil our mission, and to guarantee the sustainability of the industry and the growth of our economies.

The steps we need to take are multi-layered and multi-dimensional:

- it's about the value proposition at the level of the firm but also the working of the eco-system; and
- it's about delivering on the needs of society but also supporting broader and deeper societal understanding of the role of investment.

As an industry we need to take advantage of the opportunity to play our part in helping to rebuild trust structurally. It's *the* opportunity to align our interests with those of clients in favour of shared successes and sustainable practices. This will not only ensure value for customers but, I would also argue, improves the long-term health and sustainability of the industry.

**Abridged version of a speech by Andreas Utermann,** *CEO of Allianz Global Investors, and member of the ICMA Board, at the Asset Management and Investors Council (AMIC) Conference on 22 November 2018 in London.*

 

# The transition to risk-free rates in the euro area

*By David Hiscock and Charlotte Bellamy*

## Background

RFR

The most widely used interest rate benchmarks for financial contracts denominated in euro are EONIA and EURIBOR, both of which are administered by EMMI, the European Money Markets Institute. These benchmarks are based on the unsecured interbank market and, in the context of the EU's Benchmarks Regulation (the BMR), have both been designated as "critical benchmarks".

In September 2017, the Working Group on Euro RFRs was launched. It was tasked with the identification and adoption of a "risk-free overnight rate" (RFR) able to serve as a basis for an alternative to current benchmarks used in a variety of financial instruments and contracts in the euro area.

Having developed key selection criteria for a robust alternative rate, the working group identified three rates with characteristics that could potentially qualify them to become the euro RFR. Based on further discussion and the feedback received from a public consultation, on 13 September 2018, the working group announced its recommendation that the euro short-term rate (ESTER) be used as the RFR for the euro area; and as the replacement for EONIA. ESTER is a new wholesale unsecured overnight bank borrowing rate, which the ECB has committed to produce on a daily basis, by October 2019, based entirely on money markets' statistical data reported to it daily by banks.

On 9 November, at the ECB in Frankfurt, the working group hosted a roundtable, which is now available as a webcast, together with the supporting slides. The purpose of this roundtable was to explain to market participants the reasons behind the recommendation of ESTER as the preferred euro RFR; make the features of ESTER better known to future users; and discuss the next steps in the transition. During the roundtable, drawing from the *IBOR Global Benchmark Transition Report* published in June 2018 by ICMA together with AFME, ISDA, SIFMA and SIFMA AMG, ICMA delivered a short address regarding how to prepare for the transition.

Complementary to this identification and recommendation of an alternative RFR, the working group has established three sub-group workstreams which are focused on (i) identifying and recommending a term structure on the RFR; (ii) contractual robustness for legacy and new contracts; and (iii) transition from EONIA to ESTER.

## Transition from EONIA to ESTER

There is particular urgency relating to the transition from EONIA to ESTER, as EMMI has made public its conclusion that, under current market conditions, EONIA's compliance with the BMR "cannot be warranted". This stems from the fact that in 2018, underlying volumes for EONIA have averaged just below 5 billion euros per day and have fallen below 1 billion euros on a handful of occasions, owing to local business holidays. These factors reflect prolonged structural change in the underlying interbank lending market. In light of its non-compliance with the BMR, the usage of EONIA will, as the law currently stands, be restricted as from 1 January 2020.

But transition will be challenging, including because of the fact that ESTER is only currently assured to be available on a daily basis by October 2019. It is possible that this timeline will be changed, as the European Commission, together with the co-legislators, the European Parliament and Council, are debating potential legislative amendments which would allow for the extension of the transition period in the BMR, potentially for a further two years – taking it to a new end date of 31 December 2021. But, for now, there is no certainty that such extension will be agreed, and the market needs to continue to plan on the assumption that the BMR transition period will end on 31 December 2019.

The restriction imposed by the BMR means that supervised entities must not use EONIA in securities or derivatives traded on a venue or via a systematic internaliser, nor in certain consumer loans or investment funds. Continued use in legacy, as opposed to new, contracts is likely to be possible, subject to approval by the FSMA. This, however, clearly depends upon a value for EONIA continuing to be available on a daily basis.

On 20 December, the working group called on market participants and all other interested parties to comment on its technical analysis of the paths available for transitioning from EONIA to ESTER, as well as on its recommendation of the preferred transition option. This working group recommendation is that EMMI, as the administrator of EONIA, should take the following steps before 1 January 2020:

(a) Modify the current EONIA methodology to become ESTER plus a spread for a limited period, in accordance with Financial Stability Board (FSB) recommendations and IOSCO Principles for Financial Benchmarks to further anchor EONIA's methodology in transactions.

(b) Engage with the relevant authorities to ensure the compliance of EONIA, under its evolved methodology, with the EU Benchmarks Regulation.

(c) Consider and consult market participants on discontinuing the publication of EONIA under its evolved methodology, after a transition period that ensures firms can achieve transition to ESTER in a smooth manner and that pays due regard of the existing EONIA legacy book. This transition period should last until the end of 2021, which is consistent with benchmark transitions in other jurisdictions.

The working group also invites EMMI to take the following considerations into account:

(a) that an EONIA-ESTER spread methodology is considered which is based on a simple average with an observation period of at least 12 months, combined with a 15% trimming mechanism;

(b) that the recalibration methodology and the effective determination of the spread are announced at the same time and before ESTER's first day of publication;

(c) that the recalibration date is on the first day of ESTER's publication for simplicity reasons.

The working group recommends that market participants gradually replace EONIA with ESTER as a reference rate for all products and contracts and make all adjustments necessary for using ESTER as their standard benchmark after the transition period (including making the appropriate changes to their systems to enable a T+1 publication). The working group also encourages market participants to make all reasonable efforts to replace EONIA with ESTER as a basis for collateral interest for both legacy and new trades with each of its counterparties.

## The situation relating to EURIBOR

Meanwhile, EURIBOR is presently a quote-based interest rate benchmark available for eight tenors; and is currently undergoing reforms, led by EMMI. Given the low levels of activity in the underlying markets which the two-week, two-month and nine-month EURIBOR tenors intend to represent, EMMI announced the cessation of these three tenors, as of 3 December 2018.

Considering the remaining five tenors – one week, as well as one, three, six and twelve months – as the current, quote-based methodology is not compliant with the BMR, on 17 October, EMMI announced the publication of its second stakeholder consultation, for comment by 30 November, on a hybrid methodology for EURIBOR – which leverages market transactions whenever available and is composed of a three-level waterfall model.

This second consultation paper presents a summary of EMMI's findings during the hybrid EURIBOR testing phase and provides details on EMMI's proposals for the different methodological parameters. By early 2019, EMMI will publish a summary of the feedback received and a thorough view of the final methodological blueprint, including a concrete timeline and next steps. EMMI expects to file for authorisation to the Belgian FSMA (the relevant national competent authority under the BMR) by Q2 2019 and, subsequently, will transition panel banks from the current EURIBOR methodology to the hybrid methodology – with a view of finishing the process before the end of 2019.

It seems reasonably clear that this ongoing reform work will allow that EURIBOR can become a BMR compliant benchmark – as is already the case for LIBOR. For EURIBOR this will solve the immediate challenge of the BMR but does not solve longer-term concerns – that there are relatively few actual transactions in each tenor on a daily basis and that panel banks could prove reluctant to have to continue submitting rates. Hence, as with LIBOR, pressure to transition away from EURIBOR use should be expected.

## ESTER-based term structure methodology

The situation relating to EURIBOR described above adds to the importance of ensuring that there are robust fallback rates identified, in case EURIBOR should at some point cease to be available, and to ensure that documentation suitably references such fallback rates. Accordingly, with

ESTER established as the euro RFR, the working group is also seeking market feedback, through a consultation launched on 20 December (for comment by 1 February) on its assessment of alternative ESTER-based term structure methodologies that can serve as a fallback for EURIBOR-linked contracts, as well as on their specific use cases.

The working group has considered a variety of potential term rate methodologies which are discussed in the consultation. Term rates can be backward-looking or forward-looking. Backward-looking term rates are based on simple mathematical calculations on the past realised daily fixings of the overnight risk-free rate (ie ESTER) over a given period in time, whereas forward-looking term rates are based on derivatives markets of the underlying RFR. A backward-looking methodology is easy to understand and to construct. However, the working group recognises the potential need for a forward-looking methodology for cash flow forecasting and for managing interest rate risk, especially in the mortgage, loan and debt securities markets, so the working group will ultimately consider both approaches.

The focus of the public consultation is to seek feedback on the need for term rates in different products, and on the analysis of forward-looking methodologies to obtain term rates which could serve as appropriately robust fallbacks. The working group developed key selection criteria rooted in IOSCO principles and identified four forward-looking approaches building on, as yet non-existent, ESTER-based derivatives markets (overnight index swap (OIS) and futures markets) for deriving a euro risk-free term rate.

It is acknowledged that any assessment of such risk-free term rates would necessitate a successful transition from EONIA to ESTER with a significant transfer of liquidity to ESTER OIS markets; a transparent and regulated underlying derivatives market such as trading on multilateral trading facilities; and sufficient sources of data to capture the majority of market activity. Against this background and making these assumptions, the working group assessed three approaches for deriving term RFRs by building on OIS markets and one based on futures markets. Under the defined main assumptions, a majority of its members expressed a preference for the OIS quotes-based methodology as the methodology that is most likely to be viable at the present time.

The working group also expects the feedback from this consultation to help in assessing the suitability of a one-size-fits all, versus a product-specific, approach for a fallback rate. As part of the subsequent evaluation, the working group will assess various factors impinging on a broad-based market adoption of the recommended term RFR, including hedging and accounting issues, and will address the issue of the credit spread difference between EURIBOR and ESTER-based curves.

## Contract robustness

ICMA is closely monitoring this continuing work of the sub-group workstreams of the Euro RFR Working Group and is actively participating in the sub-group on contract robustness. This sub-group's key deliverables (as described in the sub-group's terms of reference) are: (i) to analyse the legal risks and impact of embedding fallback provisions referencing newly defined RFRs, or, where appropriate, a replacement of references to EONIA and EURIBOR with references to newly defined RFRs (and term/credit spreads where appropriate) in legacy contracts; (ii) to define solutions to embed fallbacks, and replacements where appropriate, for EONIA and EURIBOR; and (iii) to suggest measures to enhance the legal soundness of references to newly defined RFRs (and term/credit spreads where appropriate) in new contracts, taking into account consumer protection interests.

A key area of focus for this sub-group recently has been to provide legal input into the sub-group on EONIA transition. Going forward, it is expected that the sub-group will publish some information relating to the current legal frameworks and market practices in relation to EONIA and EURIBOR references in contracts for cash products and guiding principles for more robust fallback clauses in cash products in early 2019.

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**Members expressed a preference for the OIS quotes-based methodology as the methodology that is most likely to be viable at the present time.**

# The impact of the EU BMR on the use of third country benchmarks *By Patrik Karlsson*

RFR

## Introduction

The EU Benchmarks Regulation (BMR) was agreed and published in the EU *Official Journal* in 2016 as Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds.

The BMR came into force on 30 June 2016, with a number of provisions relating to critical benchmarks coming into effect immediately, and the majority of the provisions coming into effect on 1 January 2018, subject to transitional measures.

The BMR has significant implications for those who provide, use and contribute to those indices caught by the BMR definition of "benchmark"[1], which is deliberately broadly drafted to capture a wide range of financial products and use cases, including the administration and use of equity, bond and FX indices.

Recent years have revealed the weaknesses in the formulation of some widely used benchmarks, which alongside structural changes in financial markets have served to undermine the viability of several widely used benchmarks. Furthermore, the far-reaching consequences of the BMR are perceived to have already resulted in reduced contributions to benchmarks and increased compliance costs and regulatory burdens for benchmark administrators, presenting a real test to the viability of many benchmarks and investment strategies which rely on them.

The purpose of this note is to examine in detail a very specific part of the BMR, focusing *on the impact on EU investors* (caught as "users") from the provisions *on third country non-critical benchmarks*[2]. It is important to note that this paper will not address the issues involved in the use of critical benchmarks. (More information on ICMA's work on critical benchmarks is contained in other articles in this Quarterly Report and on the ICMA website).

Given international bonds with floating rates will typically reference critical benchmarks (such as LIBOR or EURIBOR), it is expected that this note will primarily be relevant for EU investors that use benchmarks within the scope of the BMR (eg for measuring the performance of an investment fund), rather than sell-side market participants in the international bond market.

## Provisions on third country non-critical benchmarks

If they want their benchmarks to be used in the EU, third country benchmark providers must take certain actions prior to 1 January 2020 to ensure their benchmarks *can* still be used in the EU. The BMR makes it illegal for any EU market participant to make BMR-defined "use" of a third country benchmark unless that benchmark is equivalent, recognised or endorsed and, crucially, included in a register maintained by the European Securities and Markets Authority (ESMA).

1. A benchmark is defined in Article 3(3) of the BMR as "any index by reference to which the amount payable under a financial instrument or a financial contract, or the value of a financial instrument, is determined, or an index that is used to measure the performance of an investment fund with the purpose of tracking the return of such index or of defining the asset allocation of a portfolio or of computing the performance fees."

2. The BMR empowers the European Commission to designate critical benchmarks in Article 20(1), which the Commission has done by a Delegated Act in October 2018, containing four benchmarks: EURIBOR, EONIA, LIBOR and STIBOR. All other benchmarks caught by the BMR will be considered "non-critical" benchmarks.

To put the legal requirement more broadly, any benchmark administrator based outside of the EU that provides benchmarks that are used in the EU by a supervised entity[3] will be subject to the third country regime requirements of the BMR and thus defined as a third country administrator. Subject to the transitional requirements discussed further below, for benchmarks administered by a third country administrator to continue to be used in the EU after 1 January 2020, the third country administrator must comply with the requirements of the BMR.

While third country benchmark administrators must consider the appropriate route for their benchmarks to be used in the EU, EU users, such as investment funds, insurance companies and pension funds have to map their current use of third country benchmarks in the eventuality that third country administrators do not want to or cannot achieve equivalence, authorisation or recognition in the EU. Performance measurement is one aspect of BMR impact, but an investment fund could also be captured by BMR through its strategy to replicate or track the performance of an index or indices, through either synthetic or physical replication of such indices.

It is important to note, however, that the BMR exempts central banks from its rules under Article 2(2)(a). Also, Article 2(2)(b) exempts "public authorities" where they "contribute data to, provide, or have control over the provision of, benchmarks for public policy purposes, including measures of employment, economic activity, and inflation". Therefore, benchmarks or indices administered by central banks or public authorities (eg SROs or organisations with similar characteristics to public authorities) will not be caught by the rules and can continue to be used by EU users.

## Using a benchmark

Article 29 of the BMR stipulates that an EU supervised entity may only use a benchmark (or combination of benchmarks) if the benchmark is provided by an EU benchmark administrator (on the official ESMA register) or a third country benchmark in the official ESMA third country benchmark register.

It is worth specifying what "use of a benchmark" entails, as the rules are specific while deliberately designed to be broad. Article 3(7) defines "use of a benchmark" to include:

(1) issuance of a financial instrument which references an index or a combination of indices;

(2) determination of the amount payable under a financial instrument or a financial contract by referencing an index or a combination of indices;

(3) being a party to a financial contract which references an index or a combination of indices;

(4) providing a borrowing rate as defined in in the consumer credit directive, calculated as a spread or mark-up over an index or a combination of indices and that is solely used as a reference in a financial contract; or

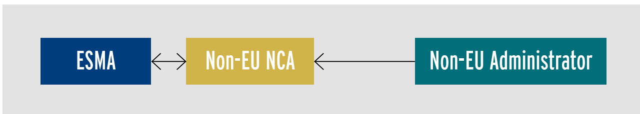
(5) measuring the performance of an investment fund through an index or a combination of indices for the purpose of tracking the return of such index or combination of indices, of defining the asset allocation of a portfolio, or of computing the performance fees.

Furthermore, "financial instrument" is defined as one that is traded on a trading venue (TOTV) or by a Systematic Internaliser (SI), as set out in the Markets in Financial Instruments Directive (MiFID II).[4]

## The ESMA register

Article 36 of the BMR empowers ESMA to set up a list of eligible third country benchmarks. EU users of benchmarks can only use third country benchmarks registered on this list. ESMA's third country benchmark website is live but does not yet at the time of writing (January 2019) have a single entry.

## Equivalence




The BMR establishes equivalence between a third country and the EU as the base line for the use of third country benchmarks in the EU.

Accordingly, in order for a third country benchmark to be included in the ESMA register, it must comply with the following:

(1) an equivalence decision has to be adopted by the European Commission (on advice from ESMA) for the country of the administrator;

(2) the administrator has to be authorised or registered and supervised in that country;

(3) ESMA has to be notified by the administrator of its

3. An EU supervised entity is defined in Article 3(17) of the BMR as EU authorised: (1) banks, (2) investment firms, (3) insurers and re-insurers, (4) UCITS and AIF investment funds, (5) pension funds, (6) creditors as defined in the consumer credit directive, (7) non-banks for the purposes of credit agreements, (8) market operators as defined in MiFID II, (9) central counterparties, (10) trade repositories and (11) benchmark administrators.

4. Article 3(16) of the BMR, referring to MiFID II (Directive 2014/65/EU).

consent for the benchmark to be included in the register; and

(4) there must be cooperation arrangements between ESMA and the third country regulator.

The equivalence decision under (1) above can be a general one finding that the legal framework and supervisory practices of a third country are equivalent to the BMR, taking into account whether the third country's rules and practices at a minimum conform to the IOSCO Principles for Financial Benchmarks or the IOSCO Principles for Price Reporting Agencies (PRAs). The decision can also be a more specific one finding that binding requirements on specific benchmark administrators are equivalent to the BMR.

The BMR also recognises that it will take some time before equivalence decisions are adopted (or even undertaken at all), so there are two other ways for third country benchmarks to be included on the ESMA register: (1) recognition and (2) endorsement, detailed below.

It is important also to establish that there are cooperation arrangements in place under (4) above before equivalence can be effective.

For those jurisdictions considering equivalence, it is important to note that ESMA issued guidelines for non-critical benchmarks on 20 December 2018, proposing certain changes to the requirements for non-critical benchmark administrators in (1) the oversight function, (2) input data, (3) transparency of methodology and (4) governance of contributors.[5]

## Recognition


A benchmark provided by a third country administrator can still be used by EU supervised entities without the aforementioned equivalence procedure by being recognised by a competent authority of an EU Member State, who effectively becomes accountable for the provision of the third country benchmark in the EU.

The third country administrator seeking recognition may demonstrate compliance with the BMR by proving it applies the IOSCO Principles for Financial Benchmarks or the IOSCO Principles for Price Reporting Agencies.

The third country administrator must have a legal representative in the relevant EU Member State, acting on behalf of the third country administrator and who will be accountable to the relevant competent authority.

Determining what is the relevant Member State ("Member State of reference") is stipulated in Article 32(4) based on a waterfall of options, depending on the presence and activity of the third country administrator in the EU.

Upon successful recognition, ESMA would include a third country benchmark administrator in its register.

It is worth noting that the on-going legislative process on the proposal to review the powers of the European Supervisory Authorities (ESAs) will likely change the way the recognition process works.

If the current proposals are agreed, the third country benchmark administrator together with their legal EU representative would apply to ESMA directly instead of a national competent authority for recognition. However, the ESAs review is not yet agreed, and once it is agreed and published in the *Official Journal*, it will take 18 months to implement and apply. Furthermore, under current proposals, ESMA would not take up its supervisory powers until 36 months after the entry into force of the ESAs' review.

## Endorsement


The final route for EU supervised entities to use third country benchmarks is endorsement. Under this route, an authorised EU-based benchmark administrator can apply to an EU competent authority to endorse a third country benchmark administrator's benchmarks for use by EU-supervised entities. This can also be done by any EU-supervised entity with a "clear and well-defined role within the control or accountability framework" of the third country benchmark administrator.

The EU administrator (or supervised entity) has to:

(1) prove that the third country administrator provides the benchmark in accordance with rules at least as strict as the BMR;

(2) have the necessary expertise to monitor effectively the provision of the third country benchmark; and

(3) ensure there is an "objective reason" to provide the benchmark in a third country and to be endorsed in the EU.

The endorsed benchmark will be considered the benchmark of the EU authorised benchmark administrator (or

5. ESMA Guidelines on Non-Significant Benchmarks, 20 December 2018.

supervised entity), responsible for compliance with the BMR. The "objective reason" test is subject to a future delegated act from the European Commission, so any entity starting to pursue this route must bear this in mind.

## IOSCO Principles

All three options (equivalence, recognition and endorsement) indicate that as a minimum, third country benchmark administrators should comply with the IOSCO Principles for Financial Benchmarks and/or the IOSCO Principles for PRAs.

Hence, it is essential if third country administrators want to continue to allow their benchmarks to be used in the EU after 1 January 2020 within the scope of the BMR that they appropriately align their governance, risk and control framework for their benchmarks' administration operations to the IOSCO Principles. European authorities or third country competent authorities will be using the IOSCO Principles as the starting point for compliance with the BMR rules.

## Timeline and transitional arrangements

As mentioned, the BMR was applied from 1 January 2018 but there are transitional arrangements in place until 1 January 2020, including for third country benchmarks.

On 8 November 2017, ESMA updated its Q&A with more details on how the transitional arrangements will work for third country benchmarks. ESMA specified that third country benchmarks are able to be used in the EU throughout the duration of the transitional period, to 31 December 2019.

Additionally, third country benchmarks that existed prior to 1 January 2020 can continue to be used in existing contracts post 1 January 2020 until maturity, without the need for an equivalence decision, recognition or endorsement.

After 1 January 2020, however, the use of existing non-compliant third country benchmarks is not allowed in respect of new financial instruments, contracts or measurements of the performance of an investment fund within the scope of the BMR.

At the time of writing, there is discussion in the EU to extend the transition period for critical benchmarks by a further two years in line with the Working Group on Euro Risk-Free Rates *High Level Implementation Plan*. Although there have been requests for a similar extension regarding non-critical benchmarks, this is unlikely to be granted and, if that is the case, any extension for critical benchmarks would not impact the existing 1 January 2020 deadline for non-critical benchmarks.

## Issues with the third country benchmark equivalence, recognition and endorsement

With less than one year to go before the 31 December 2019 cut-off date, it remains unclear how third country benchmarks will be able to be used by supervised entities in the EU after 1 January 2020. All three methods – equivalence, recognition and endorsement – are problematic for third country benchmark administrators to comply with by the deadline (or at all), as evidenced by the lack of a single third country benchmark on ESMA's register.

Regarding equivalence, many third countries will not have equivalent legislation and regulation in place to the BMR and may have no intention of enacting such legislation. In other countries, regulation of critical benchmarks may be in place, but not for the BMR-defined non-critical benchmarks addressed in this paper (which may be "critical" in third countries). Even where equivalent legislation and regulation may be in place, there may not be sufficient time for the European Commission to issue an equivalence decision.

One of the problems with the recognition route is the waterfall of criteria to identify the "reference Member State". In the absence of data on volumes on where the benchmark is used, the third country benchmark provider may be unable to determine the right reference Member

**“ Market participants must also pay attention to the impact in relation to non-critical benchmarks, particularly regarding third countries.**

State. Another issue is that the legal liabilities and role of the EU legal representative the third country benchmark provider has to establish are unclear. Consequently, many third country administrators are likely to be deterred from going down this route. Also, the uncertainty over whether to apply now to a national competent authority or to wait to apply potentially to ESMA (as outlined above) clouds the use of this method for third country administrators.

Much remains unclear regarding endorsement as well. Allowing an EU administrator or entity to endorse a benchmark could imply a degree of interference in the benchmark. The cost and terms (including any legal liability) of allowing EU administrators or entities this role are also unclear. For recognition, the IOSCO Principles are used as a barometer, but for endorsement it may be difficult to "prove" that the rules being used are at least as strict as the BMR.

Perhaps the case where endorsement is best used is in the case of affiliate entities, where non-EU benchmarks are endorsed by the EU benchmark administrator in the same commercial group. This already exists in credit rating agency (CRA) regulation where non-EU ratings are endorsed by the EU CRA in the same CRA group. However, benchmark provision is not as concentrated in a few large global commercial groups, making this option available only to a few global benchmark providers.

Given the serious consequences of infringement of the BMR (up to 10% of global annual turnover), it is not clear whether third country benchmark providers would judge the commercial benefit to outweigh the administrative burden of complying with one of the above-mentioned routes.

## UK benchmarks after Brexit

Absent any transitional or other arrangements for the period from 29 March 2019, the UK will become a third country after Brexit. Upon the UK becoming a third country, administrators of non-critical benchmarks in the UK would have to seek registration under the BMR in accordance with the BMR third country rules by 1 January 2020.

Provided the Commission issues a positive equivalence assessment for the UK, UK-based administrators could be included in the ESMA register. However, such an assessment may be politically difficult in the current environment and subject to withdrawal, but at least the starting point will be that the UK has a look-alike regulation enacted.

## Impact on EU users

There is a significant risk that third country non-critical benchmark administrators will not achieve equivalence, recognition or endorsement for their benchmarks by 1 January 2020. The impact could be significant, but it is currently unknown as little data is available on the extent to which EU users, particularly investors, make use of third country non-critical benchmarks. However, all EU supervised entities would do well to prepare for the contingency that the current benchmarks they use from outside the EU will not be available in new contracts after 1 January 2020.

For instance, commonly used spot FX benchmarks could become unavailable for use by EU investors. This would mean EU investors, including asset managers, insurers and pension funds, would be unable to hedge their exposures to non-EU currencies and products denominated in such currencies. Commonly used equity and bond indices from outside the EU may also very well become unusable by EU supervised entities. Firms must establish the potential impact and prepare accordingly. The recently published briefing by ISDA, GFMA, FIA and EMTA goes into greater detail about the potential impact on EU users and explores some of the third country benchmarks impacted.

Also, many investment funds, seeking globally diversified returns, would replicate or track the performance of third country indices. Should such indices not be usable, the impact could be quite significant.

The impact of the UK exit from the EU will also be significant, as many widely used indices are currently administered out of London. At the time of writing it seems the index industry is waiting to see what happens with Brexit before deciding on their jurisdiction of choice. Providers have in many cases chosen dual registration in the UK and an EU jurisdiction, eg the Netherlands, on the assumption that EU markets cannot be accessed from London due to Brexit.

Investors who have mapped their use of major third country indices are monitoring the authorisation and preparedness of the index providers. It is expected that index providers will provide more clarity in the early part of 2019.

## Conclusion

The BMR represents a significant new regulatory regime for critical and non-critical benchmarks. Although much public attention has been on the provisions applicable to critical benchmarks such as LIBOR and EURIBOR, this paper clearly illustrates that market participants must also pay attention to the impact in relation to non-critical benchmarks, particularly regarding third countries.

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# Summary of practical initiatives by ICMA

The practical initiatives on which ICMA has been engaged over the past quarter, with – and on behalf of – members, include the following:

## Brexit

1 *Brexit cliff-edge risks:* ICMA made a presentation on *Brexit: Cliff-Edge Risks in International Capital Markets* to the ECB Bond Market Contact Group at the ECB in Frankfurt on 9 October. ICMA, together with ISDA, FIA and AFME, wrote to the European Commission on 7 December on temporary equivalence for UK CCPs and related matters. Following the publication of the Quarterly Assessment on *Brexit: Cliff-Edge Risks in International Capital Markets* in the ICMA Quarterly Report for the Fourth Quarter, an update is provided in this edition of the ICMA Quarterly Report.

2 *ICMA Brexit FAQs:* ICMA has posted responses to Frequently Asked Questions on the ICMA Brexit webpage. The ICMA Brexit FAQ is available in full for ICMA members.

## Transition to risk-free rates

3 *Transition to risk-free rates:* ICMA has continued to work on the transition from LIBOR and other IBORs to near risk-free rates. ICMA is participating in the Sterling Risk-Free Rates Working Group, including chairing the Bond Market Sub-Group, and also participating in the Euro Risk-Free Rates Working Group and the National Working Group on Swiss Franc Reference Rates. There are three articles relating to interest rate benchmarks and the transition to risk-free rates in this edition of the ICMA Quarterly Report.

## Primary markets

4 *Public sector issuers:* The Public Sector Issuer Forum met on 11 October in the margins of the IMF and World Bank AGM in Bali to discuss the implications of Brexit for international capital markets and progress in the transition from LIBOR and other IBORs to near risk-free rates.

5 *ICMA Primary Market Handbook:* Various updates to the ICMA Primary Market Handbook were published in December 2018, including an update to the ICMA Agreement Among Managers version 1 and version 2 in the light of the rules related to the US special resolution regimes.

6 *MiFID II/R:* ICMA's report on *MiFID II and the Bond Markets: The First Year*, which contains an assessment of the impact of MiFID II/R in the primary markets, was published on 6 December.

7 *US special resolution regimes:* ICMA published on its website a guidance note and set of FAQs on the effects of the rules related to the US special resolution regimes on capital markets documentation for vanilla, non-structured debt securities in primary markets outside the US.

8 *Prospectus Regulation:* ICMA provided feedback to the European Commission on its draft Level 2 delegated regulation and disclosure annexes on 21 December.

9 *PRIIPs Regulation:* ICMA responded briefly to the ESAs' joint consultation paper concerning amendments to the PRIIPs KID by the deadline of 8 December.

10 *Investment Firms Review:* ICMA participated in joint trade association letters to the European Commission, Parliament and Council on the third country firm regime, and has focused in particular on the implications for underwriting and placing.

11 *LIBOR fallback language consultation:* On 16 November, ICMA responded to the US Alternative Reference Rates Committee consultation on more robust fallback language for US dollar LIBOR FRNs.

12 *ICMA Primary Market Forum:* The 12th ICMA Primary Market Forum, involving issuers, syndicate banks, investors and law firms, took place at Nomura in London on 8 November, with 150 attendees. The forum featured a keynote speech by Edwin Schooling Latter of the FCA, as well as panel discussions on FinTech, RFR transition and other developments in the primary debt capital markets.

13 *Mapping of technology solutions in primary markets:* To increase ICMA's coverage of the evolving FinTech landscape, ICMA launched an exercise to map technology solutions in primary markets. The purpose is to help inform ICMA members about existing and emerging platforms and technology solutions, and thereby create greater transparency. As with the ICMA ETP mapping directory and the FinTech mapping directory for repo and cash bond operations, the mapping was published on ICMA's website on 18 December.

### *Secondary markets*

14 *ICMA SMR&R:* ICMA is consulting members on the impact of MiFID II/R and other proposed new EU regulations on the ICMA Secondary Market Rules & Recommendations (SMR&R), and has established a dedicated working group to review the ICMA SMR&R.

15 *Electronic Trading Council:* The ICMA Electronic Trading Council (ETC), a technical working group under the umbrella of the ICMA Secondary Market Practices Committee, is focusing on electronic trading and the role of technology in the evolving structure of fixed income secondary markets.

16 *CSDR settlement discipline:* Following the publication of a discussion paper on *How to Survive in a Mandatory Buy-in World,* ICMA has published an information brochure on CSD Regulation mandatory buy-ins, outlining the scope and regulatory requirements. The CSDR buy-in provisions will come into force in September 2020 and will also apply to non-EU/EEA domiciled trading entities. The brochure is part of ICMA's ongoing work to ensure industry awareness and preparedness in the international cross-border fixed income markets. ICMA is also engaged in discussions with ESMA on a number of related issues, including finding a solution for an anomaly in the CSDR provisions that potentially prohibits the payment of the buy-in or cash compensation price differential from moving in the right direction, and also for the challenge of appointing buy-in agents.

17 *MiFID II/R:* ICMA's report on *MiFID II and the Bond Markets: The First Year*, which contains an assessment of the impact of MiFID II/R in the secondary markets, was published on 6 December.

18 *MiFID II/R trading suspensions:* ICMA has published a position paper on MiFID II/R trading suspensions from the perspective of fixed income markets. The paper highlights scenarios where a blanket suspension for trading in debt instruments or related derivatives could be damaging to investors' interests and the orderly functioning of the market; and recommends that national competent authorities consider these risks, and possibly also consult market stakeholders, before imposing removals or suspensions of trading under Articles 32 and 52 of the Regulation.

19 *MiFID II/R regional workshops:* Following a series of ICMA workshops in the autumn of 2017 on the implications of MiFID II/R for fixed income trading, workshops took place in Brussels in November and Madrid in December 2018 to provide a post-implementation view on how MiFID II/R has "landed". The FCA participated in an ICMA SMPC meeting in November to discuss the first year of MiFID II/R.

20 *Asian corporate bond liquidity study:* ICMA has published a report, written by Andy Hill and Mushtaq Kapasi, on the state and evolution of the Asian corporate bond markets, as an extension of its work on the European markets.

### *Repo and collateral markets*

21 *SFTR implementation:* ICMA is continuing to help members to implement the EU Securities Financing Transaction Regulation (SFTR), through the ICMA European Repo and Collateral Council (ERCC) SFTR Task Force. The SFTR was one of the main issues on the agenda at the ERCC General Meeting in London on 17 October. The introduction of extensive reporting requirements through the SFTR is one of the major challenges that the industry is currently facing.

22 *ECB AMI-SeCo:* The ERCC is represented on the ECB's Advisory Group on Market Infrastructure for Securities and Collateral (AMI-SeCo) and is playing an active role on its Collateral Management Harmonisation Task Force and the related workstreams.

23 *Impact of post-crisis regulation:* Working jointly with the GFMA, the ICMA ERCC published a report on 17 December, which assesses the impact of post-crisis regulation on the functioning of the repo and broader securities financing transactions (SFT) markets. The report, which includes some new research in the form of qualitative and quantitative analysis, makes a number of recommendations concerning the need for further review and refinement of the post-crisis regulatory framework.

24 *ICMA ERCC Guide:* The ICMA ERCC Guide to Best Practice in the European Repo Market was last updated in December 2017. Since that time there has been continued review of the need for further refinements and a number of changes have now been agreed. Accordingly, a further revised version of the Guide was published on ICMA's website before Christmas 2018.

25 *Technology:* The ERCC is following closely how technology is shaping repo and collateral markets and the resulting need for standardisation. On 7 November, ICMA presented the FinTech mapping directory for repo and cash bond operations and ICMA's FinTech work more broadly to the ECB's FinTech Task Force, a technical subgroup of AMI-SeCo.

26 *Intraday liquidity:* The ERCC is analysing the important challenges around intraday liquidity management for the industry and assessing the need for further alignment and market practice. The ERCC Ops Group held three workshops on this topic over the summer and a larger cross-industry workshop on intraday liquidity management and shaping was held in September in London.

27 *Mandatory buy-ins:* In October, ICMA published a discussion paper on CSDR mandatory buy-ins and securities financing transactions. This is intended to form the basis for possible recommendations to ESMA for Level 3 guidance.

### Green, social and sustainability bond markets

28 *European Commission Technical Expert Group on Sustainable Finance:* Nicholas Pfaff has been appointed to represent ICMA on the European Commission Technical Expert Group (TEG) on Sustainable Finance, with the support of the GBP Executive Committee. The inaugural meeting of the TEG, which was held in Brussels in July, has been followed by monthly sessions. ICMA is especially focused on monitoring and providing input into a possible future European Green Bond Standard.

29 *France's Green Evaluation Council:* ICMA has been nominated as an observer on the Evaluation Council of France's green sovereign bond and is represented by Nicholas Pfaff. The Evaluation Council will define the specifications and schedule for evaluation reports on the environmental impact of France's green sovereign bond. The last meeting of the Council was held on 29 November in Paris.

30 *ICMA/JSDA Joint Conference:* Over 500 delegates attended the Annual ICMA and JSDA Joint Conference on *Developments in Green and Social Bond Markets: the Asian Perspective* on 11 December.

### Asset management

31 *Primary Market Investor Working Group:* A third meeting of the Primary Market Investor Working Group was held on 19 November to discuss the draft announcement terms with representatives from the ICMA lead manager and issuer communities.

32 *Covered bond legislation:* The ICMA Asset Management and Investors Council (AMIC) Covered Bonds Investor Council (CBIC) secretariat has prepared summary reports on the European Parliament Economic and Monetary Affairs Committee (ECON) opinion and the EU Council's general approach on the European Commission's proposed Directive and Regulation on Covered Bonds. As trilogue negotiations have commenced, CBIC has prepared a table of investor preferences on key issues for the negotiators.

33 *MiFID II research unbundling survey:* AMIC has issued its second AMIC FICC research unbundling survey. The purpose of the survey is to help improve market clarity on this topic, identify remaining challenges, difficulties and outstanding issues in the implementation of the new MiFID II research rules and to establish progress compared to the first survey issued in 2017. AMIC presented the survey at the 22 November AMIC Conference and it is included in the ICMA report on *MIFID II and the Bond Markets: the First Year*, which was published on 6 December.

34 *AMIC Conference:* The AMIC Conference was held in London on 22 November, with an agenda for the buy side including interest rate benchmark reform and the transition to risk-free rates, research unbundling, systemic risk in asset management and securitisation. To coincide with the AMIC Conference, a new edition of the AMIC Review, focusing on the key role of the buy-side community within ICMA, was published.

35 *Stress testing:* AMIC and EFAMA are preparing a third joint report on systemic risk in asset management focusing on stress testing. The report will outline the current regulatory framework in Europe for funds' stress testing and industry best practice in this area. The paper will recommend that regulators adopt a flexible approach to any new rules for liquidity stress testing.

### FinTech in capital markets

36 *FinTech meetings with regulators:* ICMA held a meeting with FINMA on 4 October to exchange views on FinTech in capital markets. A meeting with ESMA was held on 13 December.

37 *IOSCO FinTech Network:* ICMA, an affiliate member of IOSCO, has joined the IOSCO FinTech Network and participated in the second conference call of the IOSCO FinTech Network on 21 November. ICMA is participating in two workstreams on distributed ledger technology (DLT) and lessons learnt from innovation. The purpose of the network is to share information and practices with respect to FinTech in an informal manner.

### Other meetings with central banks and regulators

38 *ECB/ICMA meetings:* An ICMA delegation including members of the Board and Chairs of Market Practice and Regulatory Policy Committees visited the ECB on 19 November for meetings on market operations, financial stability and a lunchtime meeting with Vice-President Luis de Guindos.

39 *ICMA Regulatory Policy Committee (RPC):* Sean Berrigan, Deputy Director General of DG FISMA in the European Commission, joined the ICMA RPC meeting in Brussels on 13 December.

40 *Official groups:* ICMA continues to be represented, through Martin Scheck, on the ECB Bond Market Contact Group and on the ESMA Securities and Markets Stakeholder Group, where he has been appointed by ESMA to succeed René Karsenti; through Nicholas Pfaff on the European Commission Technical Expert Group on Sustainable Finance; and through Charlotte Bellamy on the Consultative Working Group on ESMA's Corporate Finance Committee.

41 An updated draft of the *ICMA Regulatory Grid* has been posted on a password-protected webpage on the ICMA website.

# Primary Markets

*by Ruari Ewing and Charlotte Bellamy*

## MiFID II/R: the first year in the primary markets

On 6 December 2018, ICMA published *MiFID II/R and the Bond Markets: the First Year - An Analysis of the Impacts and Challenges of MiFID II/R Implementation Since January 2018*.

It includes some specific coverage of the primary markets, which have been affected by MiFID as many underwriters participating in new issue syndicates are MiFID-authorised entities. These new measures include allocation justification recording (in relation to underwriting & placing), the inducements and costs & charges regimes, and product governance. The primary markets community has also experienced the Packaged Retail and Insurance-Based Investment Products (PRIIPs) regime, to the extent that certain bonds are potentially "packaged" and are being made available to retail investors in the EEA.

The provisions on allocation justification recording relate to MiFID firms providing a MiFID placing service to issuers being required to keep an "audit trail", non-public written record of the justification for each investor allocation made. The rationale for this is to identify potential conflicts of interest, as underwriters look to balance the interests of their issuer clients with the interests of their buy-side relationships. In practice, the underwriting community reached broad consensus on allocation recording principles, with the underwriter responsible for billing and delivery generally circulating an initial draft record that other syndicate members can then adopt (modifying it as relevant for their internal needs). The experience so far has mainly just resulted in added administration for underwriters, and it remains to be seen whether this measure will have meaningful benefits for issuers or investors.

The provisions on inducements and costs & charges require that firms providing MiFID services (eg order reception/transmission to any investor "client") disclose to their client in advance any fee/commission or non-monetary benefit received from a "third party" in relation to the client service. Firms must also *inter alia* disclose *ex ante* and annually *ex post* the costs and charges relating to the services and financial instruments concerned, (also "encompassing any third-party payments").

In practice, agreement on whether these rules apply to the disclosure of underwriting fees has varied, depending on guidance from some national regulatory sources, the type of fees involved and how individual underwriters and/or how individual transactions are organised. Moreover, the prevailing view is that investors have little or no interest in the level of bond underwriting fees as these are very rarely a material factor in making an investment decision regarding bonds.

The PRIIPs regime requires any person "manufacturing" a "packaged" product, before it is "made available" to retail investors in the EEA, to publish a key information document (KID) of no more than three pages and then regularly review it, and if needed, publish a revised KID. Any person advising on, or selling, such a product must provide retail investors in the EEA with the KID in good time before those retail investors are bound by any contract or offer.

The product governance (PG) regime characterises MiFID II persons that "create, develop, issue and/or design financial instruments, including when advising corporate issuers on the launch of new financial instruments" as "manufacturers". It requires that collaboration between manufacturers must be documented in an agreement. MiFID II persons that "offer or sell", or "offer or recommend", financial instruments are "distributors" for PG purposes (with no connection to the manufacturer being explicitly required). Manufacturers must identify, and communicate to distributors, a compatible target market of investors and periodically review that target market. Distributors must identify their own target markets (by either adopting the manufacturer's target market or refining it). These requirements are all applicable on a "proportionate" basis.

The PRIIPs regime is designed to enhance protection of retail investors participating in the structured products markets, while the PG regime imposes a type of suitability obligation on different market participants with respect to all products and investors. In this regard, the two regimes have significant problematic features that have led to unintended consequences, as well as raising concerns over the fundamental practicability of compliance.

Under PRIIPs, certain authorities have taken the position that the inclusion of a term or condition that deviates only slightly from what is regarded as a plain vanilla bond will bring that security into scope as a packaged product, requiring a KID to be produced. An example would be the inclusion of a "make whole" provision. The fact that this and other terms can be to the benefit of investors but bring a bond within PRIIPs, combined with the fact that equities are not subject to the PRIIPs regime yet present greater risks to the retail investor, has led many to question the efficacy and rationality of the PRIIPs regime. Under PRIIPs, a KID must not only be accurate but may also be interpreted to require the inclusion of all material information. The imposition of this requirement with attendant issuer liability for both a three-page KID and a full 100+ page prospectus has not only created perplexity but more significantly led many issuers to refuse to produce a KID and instead restrict placement of newly issued bonds to non-retail investors in the EEA.

The PG regime has had similar consequences. It has effectively created an investor suitability obligation, not just at the point of sale (the approach taken in the past by regulation), but also imposing this obligation on issuers, underwriters, and secondary market sellers over the entire lifetime of the instrument. The practical burden of compliance with PG has caused many EU-originated issues to curtail altogether placement of bonds to retail investors (see the 2018H1 vs 2017H1 percentage change in EUR benchmark issuance reported in the Fourth Quarter 2018 edition of this Quarterly Report).

While the goal of these primary market aspects of MiFID and PRIIPs is enhanced investor/consumer protection, it seems the impact has mainly been an increase in administrative burdens and a reduction in retail access to the bond markets. ICMA will continue to engage EU authorities and national competent authorities to better achieve desired regulatory outcomes while maintaining resilient and efficient markets.

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## Prospectus Regulation

The EU Prospectus Regulation is due to apply from 21 July 2019 and work is underway on developing Level 2 and Level 3 measures. A high-level snapshot of where things stand is set out in the box below.

Further information on the most recent developments, namely the publication by the European Commission of draft Prospectus Regulation Level 2 delegated regulation and annexes and a summary of other prospectus-related matters is also set out below.

### *Prospectus Regulation Level 1*

The EU Prospectus Regulation is final and was published in the EU *Official Journal* in 2017. Certain parts of it are already in application but it will apply in full from 21 July 2019.

### *Level 2*

#### Delegated regulation on prospectus format, content, scrutiny and approval and detailed disclosure annexes

The European Commission published a draft delegated regulation and disclosure annexes on 28 November 2018 and requested feedback by 26 December 2018. ICMA submitted its feedback on 21 December (see further details below). The Commission's deadline to adopt the delegated acts is 21 January 2019 (this deadline is set out at Level 1).

#### *RTS on key financial information for the prospectus summary, data and machine readability of prospectuses, advertisements, prospectus supplements and prospectus publication*

ESMA published its *Final Report on Draft RTS under the new Prospectus Regulation* in July 2018 (see the last edition of this ICMA Quarterly Report for commentary). ESMA's Final Report is now with the Commission, who will decide whether to endorse the proposed RTS. We understand that, if the Commission decides to endorse the RTS without amendment, the European Parliament and the Council would have a one month "non-objection period" within which to consider the RTS. This period can be extended by one month. If the European Parliament and the Council do not object to the RTS within the relevant non-objection period, or both the Parliament and the Council tell the Commission before the end of the period that they do not intend to object to the RTS, then the RTS will be published in the *Official Journal* and will enter into force on the date specified in the RTS.

### *Level 3*

#### *ESMA Guidelines on Risk Factors*

ESMA published a *Consultation Paper on Guidelines on Risk Factors* in July 2018. ICMA responded to that consultation ahead of the 5 October deadline. See the last edition of the ICMA Quarterly Report for further details.

#### *ESMA Q&A on Prospectuses*

It is anticipated that the *ESMA Q&A on Prospectuses* will require updating in order to reflect the provisions of the new Prospectus Regulation. The timing for that update is not yet clear.

### *Level 2 delegated regulation on prospectus format, content, scrutiny and approval and detailed disclosure annexes*

#### *(i) Background*

The most recent development in relation to the development of the new Prospectus Regulation regime is the publication by the Commission of a draft delegated regulation and disclosure annexes on 28 November 2018. Once finalised, the delegated regulation and annexes will form the bulk of the Level 2 provisions under the new Prospectus Regulation.

The Commission's publication follows ESMA's *Final Report on Technical Advice under the Prospectus Regulation,* which was published at the end of March 2018. The Q3 2018 edition of this ICMA Quarterly Report included an article on page 22-23 on the content of that Final Report.

The Commission requested feedback on the draft delegated regulation and disclosure annexes by 26 December 2018. ICMA submitted its feedback on 21 December.

#### *(ii) Summary of ICMA feedback to the Commission*

The opportunity to review the Commission's proposed draft delegated regulation and annexes was welcome. However, the time allowed to formulate and provide such feedback, combined with the significant drafting changes that were made to the proposed provisions in *ESMA's Final Report on Technical Advice under the Prospectus Regulation* meant that developing fulsome feedback on the draft delegated regulation and annexes was very challenging.

As a general point, debt capital market participants had previously highlighted to the Commission and ESMA that they, and NCAs, are familiar with the existing Prospectus Directive Level 2 provisions. It was therefore considered to be helpful that ESMA had not departed significantly from the language of the existing Prospectus Directive regime in the ESMA Final Report. Market participants expressed surprise at the Commission's approach of amending much of the precise drafting contained in the draft delegated regulation and draft annexes.

It appears that there was no intention to change the approach set out in ESMA's Final Report substantively. However, in some cases the drafting changes resulted in substantive differences and/or unclear disclosure requirements that could be problematic for NCAs and market participants if they are not rectified in the final delegated regulation and annexes.

ICMA submitted detailed feedback to the Commission highlighting those areas of the delegated regulation and annexes where it appeared that the drafting changes had inadvertently changed the position or resulted in an unclear disclosure requirement. Some of the particular points of concern that ICMA flagged were as follows:

**Market participants expressed surprise at the Commission's approach of amending much of the precise drafting contained in the draft delegated regulation and draft annexes.**

- The provisions of the delegated regulation relating to the circumstances in which certain non-equity securities disclosure annexes should apply are difficult to interpret and, in some cases, could be read as being out of line with the Level 1 position.
- Various provisions related to the interaction of final terms and base prospectuses that were included in *ESMA's Final Report on Technical Advice under the Prospectus Regulation* and reflected the position in the current Prospectus Directive Level 2 regime have not been carried forward to the draft delegated regulation and annexes. Although it does not appear that there is any intention to change the current approach on these matters, it is not clear why those provisions were not carried forward and in many cases it would be helpful if they were set out explicitly at Level 2.
- Persons responsible for the prospectus are required by the disclosure annexes to give a responsibility statement in the prospectus. The precise wording of these disclosure requirements has been amended in different ways in different annexes and it is no longer clear exactly what the responsibility statements would be required to say. Again, it does not appear that this was an intentional change, as the new disclosure requirements do not make sense grammatically in most cases. There are other, similar, changes in the draft annexes where drafting changes have resulted in disclosure requirements that no longer seem to make sense grammatically.
- The draft disclosure annexes envisage that, where a PRIIPs KID is used as part of the prospectus summary (which can be required by individual NCAs pursuant to Article 7(7) of the Prospectus Regulation), then any information disclosed in the summary from the PRIIPs KID would also need to be disclosed elsewhere in the

prospectus. There are concerns that this could result in unexpected results in practice.

- There is likely to be continued uncertainty in relation to the precise approach that will need to be taken in relation to the new risk factor disclosure requirements, which is expected to be one of the most significant practical changes for issuers under the new Prospectus Regulation regime when it enters into force on 21 July 2019.
- In relation to credit-linked securities, the effect of making the disclosure of information relating to the reference entity (or the issuer of the reference obligation) Category A is that it will effectively prevent issuers making such issuances under final terms, unless they have supplemented their base prospectus with the relevant information, which will add cost and time to the issuance process.

There were some positive elements to the Commission's draft delegated regulation and annexes. These included:

- the Commission's decision not to take forward the suggestion in the ESMA Final Report that a length limit on prospectus cover notes should be imposed;
- the Commission's efforts to address the detailed comments that ICMA submitted to ESMA on the simplified disclosure regime for secondary issuances to ensure that such regime is not more onerous than the disclosure regime for primary issuances;
- the Commission's change to the tax disclosure requirement so that it now refers to the issuer's "country" of incorporation rather than the issuer's "Member State" of incorporation, which is helpful for third country issuers; and
- the deletion of the definition of "debt securities" because the reference in that definition to the obligation to pay the investor 100% of the nominal value had led to certain securities such as zero coupon notes falling outside the definition of "debt securities" under the current Prospectus Directive regime, which was problematic and confusing in practice.

### *(iii) Next steps*

ICMA intends to follow up with Commission contacts in relation to the feedback it submitted in writing.

The Level 1 Regulation provides that the Commission's deadline to adopt delegated acts in these areas is 21 January 2019 (ie six months ahead of the implementation date).

### *Other prospectus-related matters*

ICMA is monitoring developments related to the European Commission Action Plan on Financing Sustainable Growth published in March 2018, under which the Commission announced its intention to specify by Q2 2019 the content of the prospectus for green bond issuances to provide potential investors with additional information.

Overall, we are expecting a busy period ahead for ICMA primary market members as they begin to prepare for the implementation of the Prospectus Regulation on 21 July 2019.

For many members, the impact of Brexit will be one part of those considerations. ICMA has published FAQs on the impact of Brexit in primary markets for its members, including a FAQ on the impact of Brexit on pan-European bond prospectus approval. ICMA will keep this FAQ under review and will aim to support members through the period ahead.

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## US Resolution Stay Regime

The US banking regulators adopted rules known as the "QFC stay rules" in 2017 to improve the resolvability and resilience of US G-SIBs and their subsidiaries worldwide, as well as the US subsidiaries, branches and agencies of non-US G-SIBs.

The rules are intended to mitigate the risk of destabilising terminations of certain contracts, which is a perceived impediment to the orderly resolution of a G-SIB. They accomplish this by requiring that those contracts include

**In some cases, the drafting changes resulted in substantive differences or unclear disclosure requirements.**

**ICMA published a note setting out a summary of the effects of these rules on capital markets documentation for vanilla, non-structured debt securities in primary markets outside the US.**

new language establishing that US regulators have the same ability to stay enforcement of termination of such contracts and to transfer such contracts away from a failing G-SIB that they would have under US bank insolvency law.

The background to these rules is a global FSB initiative related to the effective resolution of G-SIBs. The US rules are similar in concept, but different in their precise detail, to the UK's PRA contractual stay rules (see the Q2 2016 and Q3 2016 editions of this Quarterly Report for further information on the UK rules).

On 20 December 2018, ICMA published a note setting out a summary of the effects of these rules on capital markets documentation for vanilla, non-structured debt securities in primary markets outside the US (including some suggested language for relevant contracts) and associated FAQs. ICMA also inserted new language into the ICMA Agreement Among Managers version 1 and version 2 (contained in the ICMA Primary Market Handbook) to bring those agreements into compliance with the rules.

For vanilla DCM transactions outside of the US, the rules are most likely to be applicable where a US G-SIB is involved in the transaction. The rules apply to "qualified financial contracts", which is likely to include a subscription agreement, the ICMA Agreement Among Managers version 1 and version 2 and a dealer agreement. It does not, however, typically cover other capital markets documents such as a trust deed, agency agreement, deed of covenant or the security instrument itself. The rules may apply to contracts that are governed by the laws of the US as well as any other laws.

It is important to note that the rules do not require amendments to all qualified financial contracts. Instead, a qualified financial contract is only "in-scope" if it restricts the transfer of the contract (or a related interest or obligation) away from an entity that is covered by the rules, or provides for "default rights" that may be exercised against such an entity.

The first compliance deadline under the rules was 1 January 2019. The rules envisage a "phased compliance" period with different compliance deadlines applicable to different qualified financial contracts depending on the identity of the counterparties to the contract. ICMA understands that, notwithstanding the phased compliance deadlines, its US G-SIB members have been seeking to comply with the rules from 1 January 2019.

The precise impact of these rules for primary debt capital markets practitioners is difficult to state at this early stage. The ICMA publications noted above and other awareness-raising measures, along with initiatives by other trade associations such as ISDA (which has published the ISDA 2018 US Resolution Stay Protocol) are intended to help ease the burden of implementation.

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## ICMA Primary Market Handbook: recent updates

On 19 December 2018, ICMA published several updates to the ICMA Primary Market Handbook and communicated this to ICMA members and ICMA Primary Market Handbook subscribers and holders via a circular (ICMA login details are required to access the circular online).

The changes were as follows:

- A new Recommendation R3.10 was inserted in Chapter 3 relating to prior syndicate consensus for any target market dissemination under MiFID II's product governance regime.
- The ICMA Agreement Among Managers v1 and v2 was amended to include new clauses related to the new US special resolution regimes (see the article on this topic above).
- The ICMA form of Singapore selling restrictions were amended to reflect certain amendments to the Securities and Futures Act of Singapore that took effect from 8 October.

Further information (including open links to the amended pages) is available on the ICMA Primary Market Handbook amendments/archive webpage.

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# The Public Sector Issuer Forum

*By Nicholas Pfaff and Valérie Guillaumin*

The Public Sector Issuer Forum (PSIF) brings together the majority of Sovereigns, Supranationals and Agencies (SSAs) active in the European capital markets. It includes 38 institutional members, including key European DMOs, the European Commission (as an issuer), major agencies such as Kreditanstalt für Wiederaufbau (KfW) and the leading multilateral development banks, including the Asian International Infrastructure Bank, the European Investment Bank, the European Bank for Reconstruction and Development and the World Bank.

The Forum is coordinated by a Steering Committee consisting of three senior representatives representing each a key SSA constituency: Arunma Oteh (Vice President and Treasurer of the World Bank – up to December 2018), Frank Czichowski (Senior VP & Treasurer, KfW) and Anne Leclercq (Director Treasury, Belgian Debt Agency).

The primary objective of the PSIF is to promote the sharing of information and experience amongst the participants on their capital markets activity, focusing both on market practice and on the impact of new financial regulation on their operations. The PSIF is characterised by its high-quality dialogue with regulatory and public authorities. Major market participants and stakeholders are also invited from time to time for discussions on key topics relating among other to regulation, financial innovation, market liquidity and financial stability. The PSIF held three formal meetings in 2018.

The first meeting took place in March 2018, kindly hosted by BNG in The Hague. Two members of the European Commission's High Level Expert Group (HLEG) made a presentation of the final report and an update of the Commission's Action Plan on Sustainable Finance, which incorporates much of the substance of the HLEG's report.

The second PSIF meeting organized in June in London and kindly hosted by the EBRD, focused on the benchmark reform and transition to risk-free rates (RFR). The Bank of England and the FCA gave a presentation on the objectives and conclusions of the Working Group on Sterling Risk-Free Reference Rates. ICMA also provided an overview of the work undertaken by the UK Bond Market Sub-Group. ISDA summarised its work related to the amendments of its standard documentation to implement fallbacks for certain key interbank offered rates (IBORs). A presentation was also given on the Euro Working Group's recommendation of the alternative RFR.

The third meeting was held at the time of the World Bank/IMF AGM in Bali in October 2018. ICMA presented its analysis on the potential impact of Brexit on international capital markets, notably the damage to international capital markets and to financial stability if pending cliff-edge risks are not addressed and avoided. As a second topic, PSIF members shared insights on the transition planning to be implemented in the euro, sterling and US dollar financial markets to ensure a smooth and orderly shift to the related RFRs: ESTER, SONIA and SOFR.

The next full PSIF meeting will take place in March 2019, in Vienna, hosted by Oesterreichische Kontrollbank AG (OeKB).

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# The ICMA FIIF Treasury Counsel Group

*By Katie Kelly*

The ICMA Financial Institution Issuer Forum (FIIF), having been operational for eight years, has now expanded to include a sub-group for treasury legal teams, it having become apparent that treasury legal teams had no similar dedicated channel. While the FIIF comprises senior treasury representatives of the major frequent bank issuers, the Treasury Counsel Group (TCG) is open to the members of treasury legal teams who support the treasury function from a legal, compliance and risk point of view. From the ICMA point of view, the TCG is invaluable in order to support the FIIF, to maximise the benefits overall for our issuer members and to ensure that we continue to provide a comprehensive, rounded issuer voice for regulatory authorities and for other ICMA members.

For the issuers, the FIIF is a markets-based forum, dealing with market tensions and behaviours, the practical impact of market developments and the implementation of regulation on balance sheet management, new issues processes, transaction execution and investor relations. The FIIF also takes a close interest in the interplay of FinTech, automation and market electronification as it relates to all these areas.

The TCG is complementary to other, longer established ICMA primary market groups, such as the Legal & Documentation Committee. As such, as well as being a point of reference and a repository of information and expertise for the members, the TCG allows ICMA to engage with this important group on issues which are being addressed in the other primary market groups. The TCG further establishes the links between ICMA members across different constituencies by providing an open channel of communication for direct discussion: for instance, liaising with the AMIC Primary Market Investor Working Group on current market practice and future efficiencies when it comes to deal announcement terms, availability of deal documentation and availability of ISINs at deal launch.

As well as participating in the FIIF meetings directly, the TCG meets within the margins of the FIIF meetings to discuss other points of substance. However, it is important to note that, although there is significant cross-over of remit and interest within the FIIF and the TCG, one is not considered to be a substitute for the other, and the two groups will continue to co-exist independently of each other. A number of themes has emerged over the last year for the TCG, some directly in support of the FIIF's agenda, and others in support of a broader remit.

The remit includes commentary on the evolution of the Prospectus Regulation, as to which the FIIF has supported various ICMA efforts, such as the ICMA response to the ESMA consultation on risk factor guidelines. Transition to risk-free rates is of obvious interest to the TCG, many of whose firms are facing the challenges associated with how to deal with legacy bond transactions which continue to reference LIBOR post-2021. The ensuing discussion of potential outcomes and consequences is not only of high quality, but also allows ICMA to assess the feasibility of possible market-led solutions taking account of all market perspectives. The position of regulatory capital and recognition of resolution systems post-Brexit is a concern to the TCG, as is the implementation of preferred resolution strategies taking account of various central bank approaches to MREL requirements. All of these issues will be considered further at future meetings of the TCG, the first of which is taking place in January 2019.

Currently, the TCG comprises 12 of the FIIF member firms, but engagement from all financial issuers is encouraged to increase the inputs and reach of the group.

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## Asset-Backed Commercial Paper

Starting from the end of the first quarter of 2020, European money market funds will have to disclose certain information under the Money Market Fund Regulation (MMFR) to their national competent authorities (NCAs). To facilitate funds' regulatory disclosure, on 13 November 2018, ESMA opened a public consultation, for comment by 14 February 2019, on draft guidelines providing further specifications on how to fill in the MMFR reporting template. ESMA's consultation paper represents the first step in the development of such specifications by setting out detailed proposals on which ESMA is seeking the views of its stakeholders. Several of the proposals relate to the reporting of Asset-Backed Commercial Paper (ABCP) and a number of the consultation questions are also therefore ABCP-related.

Also on 13 November, ESMA issued a set of items which aim to implement the new European regulatory framework for securitisations and help promote simple, transparent and standardised (STS) securitisations. These items include draft regulatory and implementing standards (RTS/ITS) on the information and templates to be provided as part of an application by a firm to register as a securitisation repository with ESMA, as well as the operational standards and access conditions for information collected and maintained by securitisation repositories.

ESMA also published further guidance to market participants on ESMA's arrangements for being notified of a securitisation's STS status. Lastly, ESMA has published a statement addressing various topics related to its near-term implementation activities under the Securitisation Regulation. This statement aims to provide additional information to facilitate market participants' understanding around ESMA's deliverables, given that the Securitisation Regulation began to apply on 1 January 2019.

On 30 November, the ESAs issued a statement in response to industry concerns relating to severe operational challenges both in meeting the transitional provisions of the Securitisation Regulation disclosure requirements, as well as in complying with the EU requirements on risk retention, transparency, re-securitisation and criteria for credit-granting obligations on a consolidated basis by EU credit institutions engaged in local securitisation activities in third countries.

From a legal perspective, neither the ESAs nor NCAs possess any formal power to allow the disapplication of directly applicable EU legal text – for instance by issuing non-action letters, which exist in some non-EU jurisdiction – and any delays in the application of EU rules would formally need to be endorsed and implemented through EU legislation, which is outside the powers of the ESAs. Nevertheless, in light of the identified difficulties and market concerns, the ESAs expect NCAs to generally apply their supervisory powers in their day-to-day supervision and enforcement of applicable legislation in a proportionate and risk-based manner.

On 12 December, the EBA published its final Guidelines, which will provide a harmonised interpretation of the criteria for the securitisation to be eligible as STS on a cross-sectoral basis throughout the EU. These Guidelines will play a crucial role in the new EU securitisation framework that became applicable on 1 January 2019, by providing a single point of consistent interpretation of the STS criteria for all entities involved in the STS securitisation including originators, sponsors, investors, competent authorities and third party STS verifiers.

The Guidelines, developed for both non-ABCP and ABCP securitisation, clarify and ensure a common understanding of all the STS criteria, including those related to the expertise of the originator and servicer, the underwriting of standards, exposures in default and credit impaired debtors, and predominant reliance on the sale of assets.

On 14 December, ESMA received a letter from the European Commission regarding the draft regulatory and implementing technical standards on securitisation disclosures submitted by ESMA on 22 August 2018. The letter states that "the Commission intends to endorse those draft regulatory and implementing technical standards only once certain amendments are introduced." Pertinently, "the Commission requests ESMA to examine whether, at the present juncture, the "No Data" option could be available for additional fields of the draft templates. This would be particularly important for the templates for asset-backed commercial paper securitisations (for which there are no similar harmonised disclosure templates currently in use)."

Circulated on 12 December, AFME's *Third Quarter 2018 Securitisation Data Report* shows that European ABCP issuance was €129.1 billion in the third quarter of 2018. This is an increase of 18.1% versus the prior quarter and an increase of 92.0% versus the same quarter in the prior year. Multi-seller conduits (99.0% of total), particularly from France (65.5% of total) and Ireland (29.2% of total), continue to dominate as the largest issuance category in the ABCP market.

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## Primary Markets Technology Mapping Directory

ICMA has launched a comparative mapping of electronic primary bond markets solutions. The ICMA Primary Markets Technology Mapping Directory compares the key features and capabilities of over 20 technology solutions that are available for a range of functions within the issuance process of debt securities.

Fixed income primary markets are evolving, and technology is playing an increasingly important role in the issuance process of debt securities. Building on ICMA's work in relation to electronification in primary bond markets, the directory's purpose is to inform ICMA members of existing and emerging platforms and technology solutions, and thereby create greater transparency. The initiative complements ICMA's mappings of Electronic Trading Platforms as well as FinTech Solutions for Repo and Cash Bond Operations.

This unique mapping exercise explains what platforms or technology solutions are available and at what stage of the issuance process they can be used, whether they are aimed at underwriters, investors, issuers or others. It provides information on the scope of debt instruments, and what issuance methods the technology solutions apply to, amongst other features. The mapping also includes emerging platforms using distributed ledger technology which are expected to go live in the near future.

The mapping directory is intended to be a living document and, whilst it currently covers more than 20 technology solutions in total, it does not constitute an exhaustive list of providers in the market. It will be updated on a regular basis to include other existing or new solutions. Relevant providers that are not yet covered by the mapping directory and wish to join are very welcome to do so.

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**ESAs expect NCAs to generally apply their supervisory powers in their day-to-day supervision and enforcement of applicable legislation in a proportionate and risk-based manner.**

# Secondary Markets

*by Andy Hill, Elizabeth Callaghan and Gabriel Callsen*

## MiFID II/R: the first year in the secondary markets

In December 2018, ICMA published the report, *MiFID II/R and the Bond Markets: the First Year*, which assesses the impacts and challenges of MiFID II/R implementation for fixed income markets since "go-live" in January 2018. This report, which largely draws on input from ICMA's diverse sell-side and buy-side members active in the European fixed income markets, is intended to provide an overview of the first year of MiFID II/R from the perspective of bond markets, covering primary market issuance, secondary market trading, and research distribution and consumption.

The secondary market section is based on an online survey of members. In total, 37 member firms responded to the survey, of which 34 are MiFID-regulated. Ten classify themselves as buy side, 23 as sell side (including 18 systematic internalisers for bonds), and four as regulated trading venues or "platform providers". Here we provide some selected responses from the survey. A more extensive analysis can be found in the report itself.

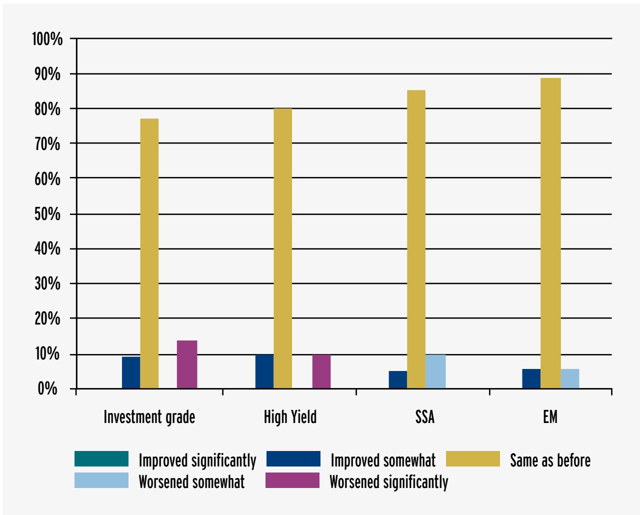
### *Market liquidity*

*Q: Since MiFID II/R took effect on 3 January 2018, how would you describe liquidity in fixed income markets, taking into consideration bid-ask spreads, time to execute, ticket size, and depth, inter alia?*

Responses to the survey seem to suggest that liquidity has remained largely unaffected across all bond asset classes. Where responses suggest some improvement or worsening, one cannot necessarily draw conclusions with respect to causality: eg market sentiment, ECB Asset Purchase Programme, etc. will also have impacted liquidity.

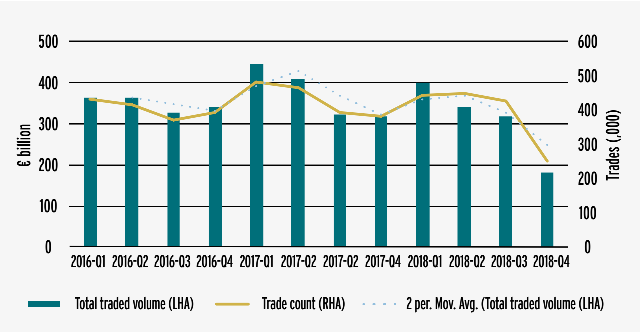
This would seem to be backed up by market data provided by Trax,[1] which shows that traded volumes (and trade count) in European IG credit, HY credit, and sovereign bond markets in 2018 are very much in line with 2017, with a small uptick in Q1 2018.

***Figure 1 – Bond market liquidity since January 2018***




1. Trax data from MarketAxess offers unique, timely insight into the European fixed income market. It combines voice and electronic traded flow, including price and volume data as well as regulatory reported information.

***Figure 2 – IG Corporate bond trading volumes***




*Source: ICMA analysis using Trax data (through 13 November 2018)*

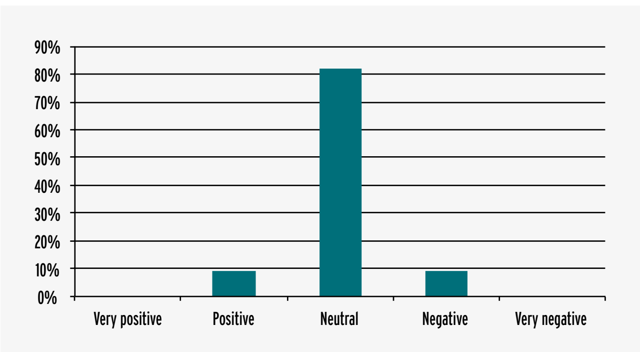
## Transparency

While greater transparency is a key objective of MiFID II/R, this seems to be work in progress as far as bond markets are concerned. Respondents suggest that, to date, post-trade transparency has not improved as a result of MiFID II/R. This can partly be attributed to the challenge of accessing trade data (86% of respondents find it "difficult" or "very difficult") as well as to the quality of the data itself (73% of respondents believe that less than 10% of the available data is usable). However, there seems to be a degree of optimism that in time the pre- and post-trade data will become more reliable; although, even by 2022, the expectations for the extent of usability seem to be mixed at best. It is perhaps no surprise that most respondents feel that price discovery is either the same or worse (90% of respondents) than pre-MiFID II/R.

Consistent with previous ICMA member feedback, the majority of respondents (86%) feel that a consolidated tape, provided as a utility (similar to TRACE in the US), would help to provide the level playing field that the regulation is intended to deliver.

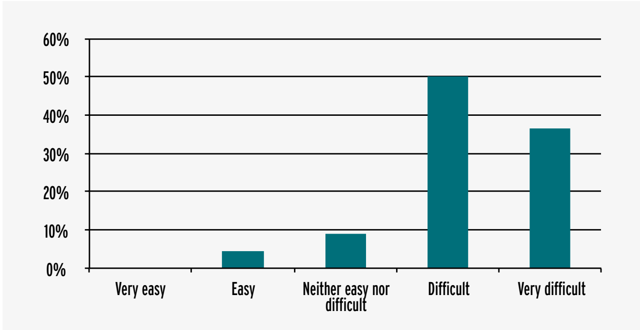
*Q: How would you describe post-trade transparency in fixed income markets in comparison to a pre-MiFID II/R environment?*

***Figure 3 – Post-trade transparency post MiFID II/R***



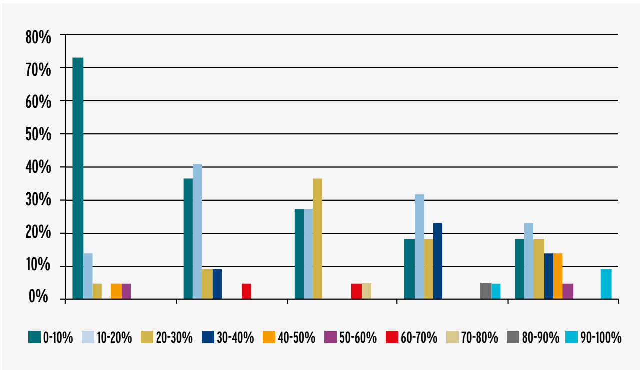

*Q: How would you describe access to publicly available APA data (both data published in near-real time and after a deferral period)?*

***Figure 4 – Access top APA data***



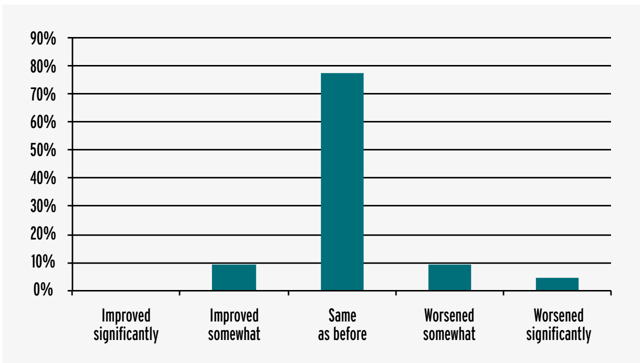

*Q: What percentage of the publicly available transparency data under MiFID II/R (pre- and post-trade) would you consider to be usable, currently and in the future?*

***Figure 5 – % usable trade data***



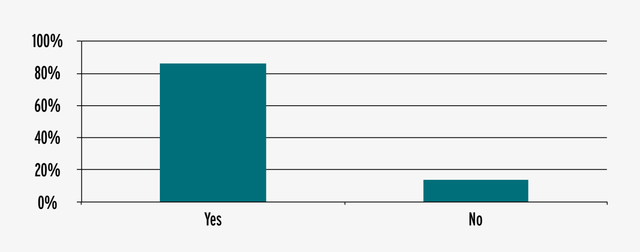

*Q: How would you describe price discovery in fixed income markets in comparison to a pre-MiFID II/R environment?*

***Figure 6 – Price discovery post MiFID II/R***



*Q: Do you consider that a consolidated tape provider (CTP), in the form of a utility (for example, similar to the US Trade Reporting and Compliance Engine (TRACE)), would be beneficial for the industry and ensure a level playing field between market participants in terms of accessibility of transparency data?*

**Figure 7 – Would a utility CTP help to "even the field"?**




## Electronic trading

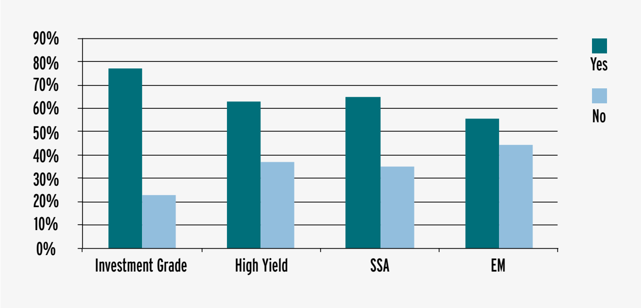
One of the objectives of MiFID II/R is to move trading in more traditional OTC asset classes (such as fixed income) onto regulated markets and trading venues. While European bond markets have been "electronified" for more than two decades, with a growing propensity for both sell side and buy side to utilise the exponentially expanding choice of new trading venues and electronic protocols, the introduction of MiFID II/R seems to have provided this already well-established trend with a slight but discernible nudge.

The survey responses suggest that, while the increase in electronic trading is not significant, it is prevalent (77% to 56% across bond asset classes) and perhaps more noticeable in the relatively more commoditised SSA and IG credit markets. What the comments (and the survey results, to an extent) do point to, however, is evidence of some firms opting to move most, if not all, of their trading onto venue (even in more traditionally OTC-based markets, such as HY and EM).

It would further seem as if much of this incremental shift to more electronic trading is through the use of "move to venue" protocols (sometimes referred to as "processed trades"), whereby the original pre-trade negotiations take place off-venue (via messaging, "chat", or over the phone), but the final execution takes place on-venue. Respondent comments suggest that "move to venue" transactions are very much client-driven, but also are by no means anything new.

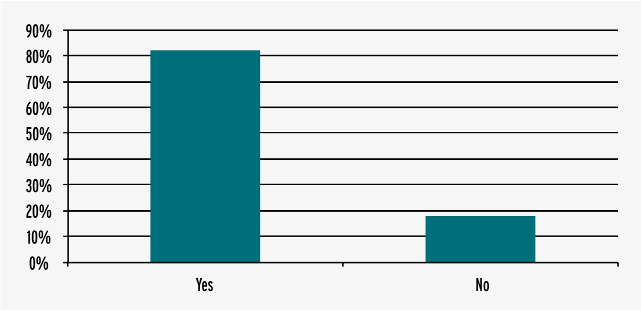
*Q: Do you execute a larger share of your tradeflow electronically since MiFID II/R entered into force?*

**Figure 8 – Increase in electronic trading**




*Q: "Move-to-venue" (or "processed") trades enable market participants to initiate a trade bilaterally, and formalise the transaction on-venue subject to the trading venue's rule book. Do you make use of this protocol?*

**Figure 9 – Use of "move to venue" protocols**




## Best execution

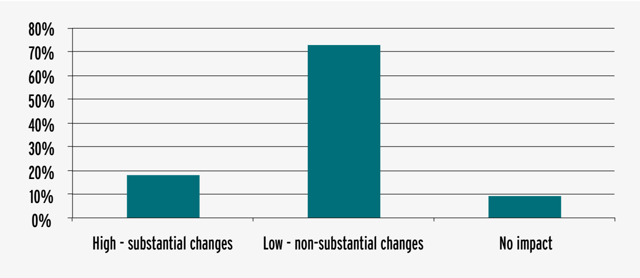
MiFID II/R requires investment firms to establish and implement an order execution policy, which must be disclosed to, and consented on by, the firm's clients. Trading venues, systematic internalisers, market makers, and other liquidity providers, are required to make data available to the public, on a regular basis, at no cost, on the quality of transaction execution. Best execution policies (including for fixed income) have existed long before MiFID II/R, while the extensive best execution-related data public reporting obligations are not only a new requirement but would also seem to be of questionable value.

Survey responses confirm that firms already had in place robust best execution policies, communicated to clients, and that MiFID II/R has not had any material impact on these (90%). The data (and comments) further confirm that the best execution data reporting requirements (under RTS 27 and 28) are challenging, time and resource-draining, and of little or no value (95%). It would further seem that the most interest in the best execution data comes from competitors and journalists – not from clients, for whom it is intended.[2]

2. Firms are able to see who downloads their RTS 27 & 28 reporting data files

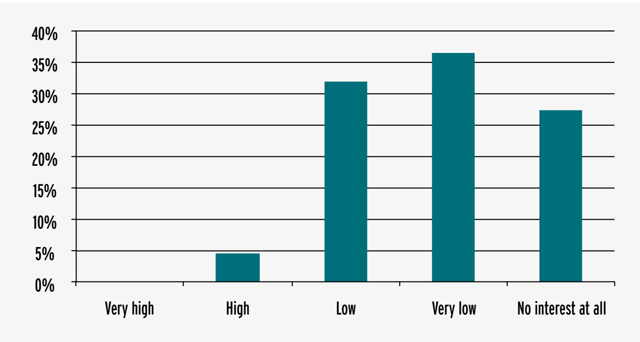
*Q: How would you describe the impact of MiFID II/R best execution requirements on your trade execution process in comparison to a pre-MiFID II/R environment?*

***Figure 10 – Impact on "best ex" process***




*Q: How would you describe interest in viewing the RTS 27/ RTS 28 reports published by your firm?*

***Figure 11 – Interest in "best ex reports"***




## *Conclusion*

In terms of secondary market impacts, the headline is that liquidity and functioning appear to have remained mostly unchanged in the wake of MiFID II/R, and that for the most part it is business as usual. However, there have been a number of shortcomings, particularly with respect to the transparency regime and the accessibility and quality of pre- and post-trade data. While there is some optimism that this will improve over time, MiFID II/R seems to have missed an opportunity to provide a utility-based consolidated tape for fixed income.

In addition, the systematic internaliser regime has thus far failed either to improve transparency or create a level playing field. Public best execution reporting is challenging and expensive to produce, but barely used by anybody. Meanwhile, MiFID II/R does seem to have helped push a little more trading onto venues, which is one of its main objectives.

But MiFID II/R is as much a journey as a destination, and it is broadly understood that it will take time (perhaps years) for the many challenges to be addressed and for any benefits to become manifest. Reports such as this will hopefully help to guide market participants and regulators alike as they continue that shared journey.

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## MiFID II/R: ESMA guidance in the fourth quarter of 2018

In the fourth quarter of 2018, the European Securities and Markets Authority (ESMA) issued further guidance in relation to MiFID II/R. The following briefing is designed to provide a non-exhaustive summary of selected guidance impacting market structure and fixed income trading, notably: (i) update on assessment of third-country trading venues for transparency purposes; (ii) transparency requirements for RFQ systems; (iii) availability of pre-and post-trade data free of charge 15 minutes after publication; (iv) obligations for systematic internalisers (SIs) in non-TOTV instruments; (v) publication of data for the systematic internaliser calculations for bonds; (vi) ESMA's liquidity assessments of bonds for Q3 2018 for transparency purposes; (vii) default liquidity status of bonds for transparency purposes; (viii) best execution reporting (RTS 28), and (ix) further ESMA guidance and Q&A updates.

### *MiFID II/R*

Overview of selected ESMA guidance in the fourth quarter of 2018:
20 December: Update on assessment of third-country trading venues for transparency purposes
14 November: Q&As on transparency issues
31 October: Systematic internaliser calculations for bonds
31 October: FITRS liquidity assessments for individual bonds by ISIN for Q3
31 October: Completeness indicators related to bond liquidity data
4 October: Q&As on market structures topics
4 October: Q&As on transparency topics
3 October: Q&As on investor protection and intermediaries topics

### *(i) Update on assessment of third-country trading venues for transparency purposes*

On 20 December 2018, ESMA provided an update on its assessment of third country trading venues (TCTVs) for the purpose of post-trade transparency (and positions limits) under MiFID II/MIFIR: "Following the publication of two opinions [in December 2017] for post-trade transparency and position limits, ESMA received requests to assess more than 200 TCTVs against the criteria set out in these opinions. ESMA, to date, has not reviewed a sufficient number of TCTVs to publish a comprehensive list. ESMA considers it important that all TCTVs receive the same treatment in order to maintain a level playing field, so will delay publication of the lists until a more significant number of TCTVs have been assessed. Consequently, pending the publication of the lists, investment firms do not have to make public their transactions concluded on TCTVs via an approved publication arrangement (APA)."

### *(ii) Transparency requirements for RFQ systems*

On 14 November 2018, ESMA issued further Q&A updates in relation to transparency topics. With regard to RFQ systems, ESMA clarified that "a quote received in response to an RFQ that contains all the necessary information to agree on a trade and therefore complies with the definition of an actionable indication of interest as defined in Article 2(1)(33) of MiFIR should be made pre-trade transparent. [...] In any case the concept of executable quotes should not be interpreted in a way that would preclude quotes that qualify as A-IOIs to be made pre-trade transparent". In addition, ESMA stated that "the definition [of RFQ systems] does not foresee the possibility to privately negotiate with one RFQ respondent to agree on the final details of the transaction. If such a bilateral negotiation is necessary, it should be considered as a separate trading process outside the initial RFQ session."

### *(iii) Availability of pre-and post-trade data free of charge 15 minutes after publication*

On 14 November 2018, ESMA amended its previous Q&A update in relation to the requirements to publish information on post-trade data 15 minutes after publication free of charge. ESMA highlighted that the requirements also apply to pre-trade data (and not only post-trade data). Amongst other points, ESMA stated that "APAs, CTPs and trading venues should also provide the data in a format that can be understood by an average reader". With regard to access restrictions, ESMA noted that "allowing access to the data via a human interface only from *ex ante* registered IP addresses does not meet the requirement to make information available to the public free of charge. However, such a restriction is acceptable for data provided in a machine readable way." Furthermore, ESMA noted that "the information should be available for any party to initiate a retrieval of the data for a period of at least 24 hours from the publication. It is not reasonable to have the data available for a period that is not long enough for it to be downloaded reliably either on an *ad hoc* or in a repeatable manner."

### *(iv) Obligations for SIs in non-TOTV instruments*

On 14 November 2018, ESMA furthermore provided clarifications in relation to the obligations of SIs and non-TOTV (traded-on-a-trading venue) instruments. "ESMA is only publishing information on TOTV instruments for determining whether an investment firm meets the thresholds to be considered as a systematic internaliser. With respect to non-TOTV instruments, ESMA therefore appreciates that it might be challenging for investment firms to access reliable and comprehensive sources of EU wide information preventing *de facto* the systematic internaliser test to be carried out. There are circumstances where an investment firm may still be a systematic internaliser for non-TOTV instruments", for example, where "investment firms opt voluntarily into the systematic internaliser regime", or where "an investment firm by virtue of qualifying as a systematic internaliser in a TOTV instrument automatically becomes a systematic internaliser in non-TOTV instruments [...] meeting the thresholds for one bond [and] automatically becomes a systematic internaliser in all bonds (ie TOTV and non-TOTV bonds) issued by the same entity for the same bond type."

With respect to quoting obligations, ESMA added that "the scope of the quoting obligations under Articles 14-18 of MiFIR is limited to TOTV instruments. In consequence, systematic internalisers in non-TOTV instruments are not subject to the quoting obligations under Articles 14-18 of MiFIR." However, "ESMA expects systematic internalisers in non-TOTV instruments to monitor the TOTV status of those instruments and comply with the quoting obligations under Articles 14-18 of MiFIR as soon as an instrument becomes TOTV."

### *(v) Publication of data for the systematic internaliser calculations for bonds*

On 31 October 2018, ESMA released the data for the systematic internaliser calculations for bonds, equity, and equity-like instruments under MiFID II/R. The calculations cover the total number of trades and total volume over the period April to September 2018 including 387,212 bonds and 17,999 equity and equity-like instruments. "The results were published only for instruments for which trading venues submitted data for at least 95% of all trading days over the 6-month observation period. The data publications also incorporate OTC trading to the extent it has been reported to ESMA. The publication includes data for instruments which are no longer available for trading on EU trading venues at the end of October."

Accordingly, volume data have been reported for 29,540 bonds out of 387,212 instruments in total. Investment firms were required to perform an internal assessment against the data provided by ESMA, and if in scope of the SI regime, comply with relevant SI obligations from 15 November 2018. Further information on the SI regime and calculations are available on ESMA's website.

### *(vi) ESMA liquidity assessments of bonds for Q3 2018 for transparency purposes*

On 31 October 2018, ESMA announced that the third quarterly liquidity assessment for bonds under MiFID II/R had been made available through the Financial Instruments Transparency System (FITRS) in XML format. The list of ISINs was subsequently published through the FITRS interface.

Accordingly, 466 bonds were deemed liquid in Q3 based on the FITRS interface (as of 15 November 2018).[3] The liquidity assessments are applicable from 16 November 2018 until 15 February 2019.

It was noted that "additional data and corrections submitted to ESMA may result in further updates within each quarter, published in FITRS (which shall be applicable the day following publication)". The list of ISINs deemed liquid by ESMA, including further details on the issuer, coupon, maturity, amount outstanding (based on data from Bloomberg) are available on ICMA's website.

### *(vii) Default liquidity status of bonds for transparency purposes*

On 4 October 2018, ESMA issued a Q&A update replacing its previous guidance regarding the default liquidity status of bonds: "In case the necessary liquidity assessment for a bond is not published in FITRS, the bond should be considered illiquid. More specifically, a bond should be deemed illiquid if:

- in the case the necessary liquidity assessment for the bond is the one based on issuance size under Article 2(1)(17)(a) of MIFIR (further specified under Article 13 (19) and (20) of RTS 2 because the bond is newly admitted to trading or first traded and such assessment is not published in FITRS; or
- in the case the necessary liquidity assessment for the bond is the one of the latest quarterly liquidity assessment based on the trading activity defined under Article 2(1)(17)(a) of MIFIR (further specified under Article 13(18) of RTS 2) when the bond is no longer considered a newly admitted to trading or first traded bond and such assessment is not published in FITRS".

### *(viii) Best execution reporting (RTS 28)*

On 3 October 2018, ESMA released a further Q&A update on best execution reporting (RTS 28) under MiFID II/R investor protection and intermediaries topics. ESMA stated that "where investment firms use the RFQ systems of a trading venue that allow the investment firm to identify the counterparty they are dealing with, the investment firm should also disclose the identity of the (five) counterparties it most commonly executes against where they have agreed the trade via an RFQ system of a trading venue that allows the firm to identify the counterparty they are dealing with. The firm should also disclose the proportion of volume traded with each of these counterparties as a percentage of the total in that class of financial instruments." Another topic addressed in this Q&A update relates to investment advice on an independent basis.

### *(ix) Further ESMA guidance and Q&A updates*

Other updates include ESMA's publication of completeness indicators related to bond liquidity data, which aims to "increase the incentives for trading venues to deliver data for the performance of […] bond liquidity calculations on a timely basis (31 October)". Furthermore, ESMA issued Q&A updates on market structures topics, notably on arranging transactions that are ultimately formalised on another trading venue (4 October), and the registration of a segment of an MTF as an SME growth market (also on 4 October). With regard to transparency topics, other ESMA Q&A updates relate to the classification of derivatives on derivatives, and the scope of pre-trade transparency waivers for derivatives under Article 9(1)(c) of MiFIR.

Further information on the aforementioned ESMA guidance can be found on ICMA's MiFID II secondary markets website.

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3. Note: In the announcement of 31 October ESMA referred to 470 bonds that were deemed liquid, most of which were government bonds. However, two Italian government bonds have matured (IT0005139099 - 15/10/2018; and IT0004922909 - 01/11/2018).

## MiFID II/R: ICMA's post-implementation workshops on cash bond trading in Europe

In the last quarter of 2018, ICMA facilitated a number of regional workshops across Europe intended to allow participants to review and discuss MiFID II post-implementation experiences since 3 January 2018, particularly from the perspective of cash bond markets. In addition, panelists were asked to gauge future trends for electronic trading and innovation with MiFID II providing the catalyst.

The workshop panels provided for comprehensive discussion regarding local challenges as well as suggesting potential solutions. The various panels[4] featured local fixed income trading and research experts, and topics discussed included: research distribution/consumption, data availability and usability, transparency and best execution, electronic trading, regulatory assistance, technology impacts, required skillsets, as well as considerations related to Brexit from an EU27 perspective. Noteworthy highlights from the panel discussions are set out below.

### *Research*

Panelists suggested that, in jurisdictions that produce country-specific research, research departments have not reduced staff. This research is considered "niche". They went on to say that survivors in the sell-side research world are and will continue to be global distributors and niche distributors. The panel predicted that it would be the intermediate research distributors who will suffer and therefore be forced to reduce research output and/or staff.

As far as research consumption is concerned, the presiding view is that it is the larger investors who retain most influence, and who can afford to pay for research, whereas the smaller investors will lose out over time. Concern was also expressed that a reduction in availability of research may deprive buy-sides of contrarian market views.

The panelists confirmed that many if not most sell-sides are using a flat fee ("all you can eat") model for research distribution. Sell-sides have been active in assessing the value and pricing of research, and panelists felt that research is being priced correctly. However, they cautioned that some sell-sides may be viewed as pricing their research in a "flat fee" model too cheaply, which could be interpreted as an inducement under MiFID II rules. Interestingly, market participants seemed uncertain of the potential recourse for either distributing or consuming research incorrectly.

In addition, there are concerns regarding roadshows, with sell-sides reporting a reduction in investor attendance. This appears to be the result of an overly conservative interpretation of research inducement rules under MiFID II and what is deemed to be "marketing". Participants suggested that more guidance on this from local regulators would be welcomed.

Finally, panelists agreed that there has been a significant increase in administrative work and expense relating to research distribution and consumption.

### *Data availability and usability*

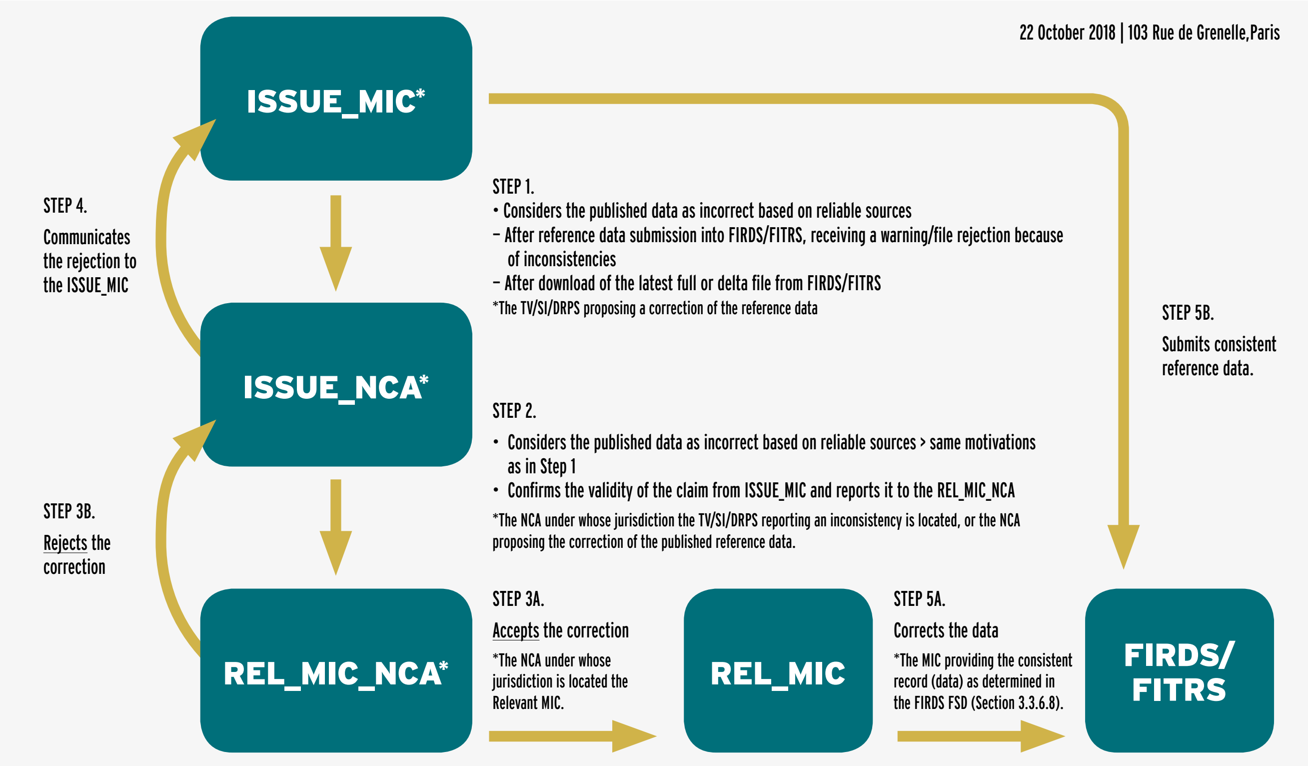
Panelists were broadly of the opinion that, with respect to pre- and post-trade data for bond markets, Europe has missed an opportunity. Currently the data is not standardised and therefore not reliably useable. One of the key problems seems to be in the data structure at the foundation level, held within the ESMA database infrastructure. There are often inconsistencies and misclassifications at the root data level, which in turn has impacts further downstream.

For example, a key cornerstone data element is the Classification of Financial Instruments (or CFI code). This contains a number of characteristics that are defined when a financial instrument is issued and remains unchanged during its entire lifetime. However, it is not unusual for the CFI codes to contain errors. Incorrect CFI codes directly affect downstream data processes such as liquidity calculations (whether an instrument is deemed liquid) and the quality of public pre- and post-trade transparency data provided by trading venues and approved publication arrangements (APAs).

Correcting CFI data errors is not straightforward. First, the market participant must inform their local national competent authority (NCA) of the error, then that NCA informs the relevant NCA of the Master Identifier Code (MIC) Master Data Record holder for that CFI data. The NCA of the MIC Master Data holder can then choose whether or not to pass on the notification of the incorrect CFI code to that relevant MIC Master Data holder. This is illustrated in ESMA's process diagram below. The view from the workshops is that this process could be simplified and made less error prone.

4. Note that participants provided their personal perspectives which may not represent the official views of their firms.

***Transversal issues: Reference data correction process***




*Source: ESMA.*

The panel discussions also focused on the notion of a consolidated tape for fixed income. Panelists were united in their view that there is no truly consolidated tape for pre- or post-trade data, and the market-driven solutions have so far not been successful. All, however, agreed that a consolidated tape in Europe is much needed and the sooner the better. Participants further expressed the view that the consolidated tape should be a non- commercial, single-source utility similar to (but not necessarily the same as) TRACE[5] in the US. The view is that data accessibility and usability will be compromised until a non-commercial consolidated (raw) data tape or "utility" is available throughout Europe.

## Transparency and best execution

The view from the panelists is that MiFID II's initial focus should have concentrated on quality of post-trade transparency (as that can be helpful in the pre-trade space as well) instead of focusing on *both* pre- and post-trade transparency data obligations. One example of a shortcoming in pre-trade transparency is the observation that buy-sides are not seeing any real difference between quotes provided by systematic internalisers (SIs) and those related to sell-side "axes". Most globally based banks have registered as SIs due to current low levels of transparency obligations and the welcome incremental approach adopted by ESMA. SI quoting practices could change, however, when the size-specific-to-the-instrument (SSTI) thresholds are reassessed going forward, increasing the scope of pre-trade transparency. It is thought that some firms may reduce SI status in various bonds due to perceived risks associated with pre-trade transparency obligations.

With respect to public best execution reporting, panelists agreed that a lot of time, money and effort is going into producing the best execution RTS 27 and RTS 28 reports. However, the panelists also broadly agreed that the data output to support best execution analysis is barely being used. The reports are being interpreted so differently by publishing firms, due to lack of reporting standardisation, that the resulting data is not useful.

## Electronic trading

MiFID II appears to have increased the move to automation and electronic trading, a trend that panelists expect to continue. Furthermore, electronic trading protocols will be increasingly utilised, particularly in conjunction with trading parameters, ie for small sizes or "odd lot" trades. Participants

5. The Trade Reporting and Compliance Engine (TRACE) is a program developed by the National Association of Securities Dealers (NASD) that allows for the reporting of over-the-counter (OTC) transactions pertaining to eligible fixed-income securities.

envisage trading being increasingly split, both on the sell side and the buy side between "no touch", "low touch" and "high touch" trading, with varying degrees of automation associated with each.

However, a lengthy discussion in the workshops took place on the subject of the difference between automation of workflow and algorithmic trading in fixed income trading. Most believe that there is a major difference between automation and electronic trading. For example, there is a concern that firms might be registering automated workflows as "algos" unnecessarily.

Algorithmic trading has its origins in equities markets.[6] The concern for regulators historically has been with respect to oversight in the case that algos result in the automated selling and buying of securities, and accordingly algos need to be registered with the relevant regulators.

However, the general view is that an automated "rules based" workflow that does *not* automatically generate buy and sell transactions *without* human intervention should *not* have to be registered as an algo. Automated workflow does not carry the same market risk as in the case of no human intervention "auto trading". Panelists commented that some firms are registering quote streaming services as algos with their regulators. Most thought this was an excessive interpretation of MIFID II/R. Similarly, some noted that automated request for quote services ("auto-RFQs") are being registered as algos, even though these quotes are generally indicative (so not actionable). Again, most participants view streaming quotes and auto-RFQs as automated workflow rather than an algo.

A corollary to this consideration appears to be that buy-sides are increasingly concerned that efforts to automate and streamline workflow may result in them having to register automated activity as an algo.

## *Regulator assistance*

Feedback from the panelists suggests that there is not enough guidance coming from most of the regulators in Europe (noting that some regulators are more helpful than others). What guidance that they do get seems to focus on retail issues and *not* institutional cash bond trading market structure issues.

Panelists advanced the idea of increased two-way interaction between the industry and local regulators, as well as ESMA, ideally through a group forum or routine roundtables, including sell-sides, buy-sides and trading venues. Participants felt that this would be beneficial for all parties, as well as helping regulators to be better aware of the continually evolving bond trading market structure ecosystem that they are charged with supervising.

## *Technology impacts in the future*

Panelists broadly asserted that technology and machine learning (or artificial intelligence) will have significant impacts on bond market structure and practices in the future. Indeed, many technological enhancements can already be felt today. Looking forward, panelists identified three key areas where they felt that technology would have most impact: research, data, and trading.

In the case of research, the panelists thought that we could see more acceptance and usage of "robo advice" as well as machine learning being harnessed to produce more tailored research. In the area of data, the panelists thought that, with better data tools and improved reference price availability, buy-sides will be better able to "make" prices (rather than being traditional price-takers). With respect to market liquidity provision, the view is that in time there will be roles where the buy-sides and the sell-sides will become less discernible. With advanced data analytical tools, leading to better reference pricing, buy-sides will feel more comfortable trading on central limit order books (CLOBs), with the buy-sides setting the price or limit as to where they will trade.

Lastly, in the area of trading, the panelists mentioned that we would likely see an increase in algorithmic tools such as auto-hedging, internal crossing on the buy-side (much more than we see today), and large orders ("blocks") broken down into smaller, more easily tradeable "bites", preserving liquidity and minimising market impact.

## *Skillsets for the future*

One panelist commented that trading will eventually be analogous to a "pilot in a cockpit". The trader will be surrounded by technology, which performs many of the more basic operations. However, the "plane" (ie the trading desk) will still need the experienced pilot (trader) for more complex operations or unexpected events. All agreed that strong analytical and quantitative skills will be essential in the future, far more than today. Another panelist went further to say that young men and women should get going and learn "Python" programming.

However, technology is unlikely to take over all trading roles in the future. Several panelists agreed that relationship management roles will increase, both in terms of relevance and bandwidth, taking on the responsibilities of flow sales and client research management.

## *Brexit*

Since these workshops were conducted in the EU27, we thought it would be appropriate to discuss views as to the potential impacts of Brexit on non-UK market participants. Again, the views expressed were those of the panelists and not necessarily representative of their respective firms.

6. Algorithmic trading is a method of executing a large order (too large to fill all at once) using automated pre-programmed trading instructions accounting for variables such as time, price, and volume.

There was agreement that market liquidity would become fragmented, as would trade reporting. Regarding liquidity, buyers and sellers could end up on different platforms, either in or outside of the EU27. As for reporting, APAs will also be both in and outside of the EU27, fragmenting the reporting and skewing transparency. The panelists further agreed that EU27 buy-sides would experience wider bid/offer spreads. They went on to say that electronic trading practices will most likely diverge between the EU27 and the UK, although the panelists did not specify exact details. Lastly, the much-desired road to a consolidated tape will become even more bumpy, as even the basic aggregation attempts that we are seeing today become hampered post-Brexit.

### Conclusion

Overall, the panels tended to be downbeat about their experiences and the impacts of MiFID II/R since 3 January 2018. However, they did seem to suggest that the various identified challenges will improve over time, particularly the quality and usability of data. Once the data improves, the panelists were optimistic that the benefits will help bond trading practices evolve and grow.

One further useful outcome of MiFID II/R, on which participants could all agree, was that it has forced firms to undertake an in-depth review of their business and current workflow and practices. By looking "under the hood" of their respective businesses they have been able to identify efficiencies needed in their business models and plan accordingly. Business rationalisation and future-proofing have thus turned out to be a beneficial externality of MiFID II for many market participants.

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## CSDR Settlement Discipline

The CSDR Settlement Discipline provisions, particularly those for mandatory buy-ins, are expected to have a seismic impact on European bond market structure and liquidity provision when they come into force in September 2020, not least with respect to corporate bond markets.

ICMA's work on CSDR Settlement Discipline is focused primarily on the implementation of mandatory buy-ins, both for cash bonds and in-scope securities financing transactions (SFTs). The ICMA CSDR-SD Working Group consists of a broad range of sell-side and buy-side traders (cash and repo), as well as operations, compliance, and legal experts.

### Updating the ICMA Buy-in Rules

The ICMA Buy-in Rules are included in the ICMA Secondary Market Rules & Recommendations which form the contractual basis for transactions in "international securities"[7] between ICMA member firms (including both sell-side and buy-side). The "Rules" are widely relied upon in the international, non-cleared bond markets.

ICMA is in discussion with ESMA with a view to updating the ICMA Buy-in Rules to align with the CSDR buy-in requirements from September 2020.[8] The updated Rules are intended to support implementation of the CSDR requirements, provide for market best practice, as well as addressing the potential asymmetry in the buy-in/cash compensation differential payments.

Based on further feedback from ESMA, ICMA will begin a formal consultation with members and the broader market on the final details of the Rules and to ensure alignment with other potential market initiatives.

### Addressing the potential CSDR payment asymmetry

The CSDR framework for buy-ins and cash compensation contains a potentially anomalous asymmetric treatment for how the buy-in/cash compensation price differential is settled between the seller and purchaser. Apparently the result of a drafting error in the Level 1 text, the payment of the differential between the original transaction price and the buy-in or cash compensation reference price appears to be payable only in one direction (from the seller to the buyer), which causes a number of potential problems, including unusual economic outcomes arising from the buy-in and adverse behavioural incentives for both sellers and buyers.[9]

ICMA is in discussion with ESMA with a view to addressing the potential asymmetric provisions in CSDR for the payment of the buy-in or cash compensation differential (from the perspective of non-cleared markets) by means of a contractual solution. It is hoped that parties will be able to contract to settle the buy-in or cash compensation differentials in either direction (between purchaser and

7. For the purpose of the Association's rules and recommendations, an international security is a security intended to be traded on an international, cross-border basis, and capable of settlement through an international central securities depository or equivalent.

8. It seems likely that there will be more than one version of the ICMA Buy-in Rules, depending on whether transactions are in- or out-of-scope of the regulatory requirements.

9. This is discussed in detail in the ICMA discussion paper, *How to survive in a mandatory buy-in world*

**ICMA's advocacy efforts are primarily focused on Level 3 guidance to support implementation with minimum adverse impact for bond market efficiency, liquidity, and stability.**

seller), depending on whether the buy-in/reference price is higher or lower than the original transaction price (consistent with current market practice).

It is important to note that, in the case of the ICMA Buy-in Rules, ICMA will also be seeking an external legal opinion on the enforceability of the Rules under CSDR.

### *Pass-ons*

ICMA has prepared a draft proposal for a potential pass-on mechanism that could work under CSDR. It is based on existing pass-on mechanisms (such as that established in the ICMA Buy-in Rules), and seeks to address the two key potential challenges posed by the CSDR buy-in design:

(i) the *incentive* for parties in the chain, other than the final purchaser, to initiate a buy-in process;
(ii) the *requirement* for parties in the chain, other than the final purchaser, to initiate a buy-in process.

The former can be resolved by means of ensuring that parties can contract to settle the buy-in/cash compensation differential symmetrically (so eliminating the incentive for parties in a chain to initiate a buy-in immediately in a falling market).

The proposal to resolve the second challenge is that the obligation to initiate the buy-in process is passed along a chain in the case where a party has a matching sale, subject to:

(i) the matching purchase and sale are in the same security;
(ii) the matching purchase and sale are for the same nominal amount;
(iii) the matching purchase and sale are within the extension period.

ICMA has circulated the proposal among the CSDR-SD Working Group and other associations and welcomes input to help refine the proposal further. Ideally ICMA would like this to be a consensus cross-industry proposal.

### *Securities financing transactions*

The CSDR-SD Working Group, in collaboration with the European Repo and Collateral Council (ERCC) is looking at the practicalities and challenges of applying the CSDR buy-in provisions to in-scope SFTs, with a view to drafting proposals for ESMA Level 3 guidance. Issues include: treatment of open trades; practicalities of buy-in SFT start-legs; and adjusting for haircuts.

ICMA intends to work closely with ISLA (and other interested bodies) to ensure that any proposals related to SFTs have industry consensus.

Many of the challenges associated with applying buy-ins to SFTs are explored in ICMA's discussion paper, *CSDR Mandatory Buy-Ins and Securities Financing Transactions*.

### *Awareness*

ICMA is very focused on raising awareness of the scope and application of the CSDR-SD provisions among its sell-side and buy-side constituents, particularly outside of the EU. It is doing this through publications, articles, webinars, as well as flagging the regulatory requirements and potential impacts in member meetings and on calls.

For now, ICMA's advocacy efforts are primarily focused on Level 3 guidance to support implementation with minimum adverse impact for bond market efficiency, liquidity, and stability.

More information and resources related to ICMA's extensive work on CSDR-SD can be found on its dedicated webpage.

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# ICE Data Services Corporate Bond Market Liquidity Tracker

ICE DATA SERVICES™

**December 2018**

### *Liquidity Tracker*


*Source: ICE Data Services*

### *Commentary*

As discussed in previous Quarterly Reports, corporate bond market liquidity appears to show a sharp decline in Q1 2018, which largely correlates with the US led sell-off in global credit markets. But IG remained relatively rangebound through Q3, and increased markedly in Q4 reaching similar or even higher levels than in Q4 2016.

EUR and GBP HY liquidity, however, shows a fairly steep decline through Q2 and Q3, which continues in Q4, albeit not at the same pace.

While it is difficult to attribute causality, a possible explanation for the deterioration in EUR HY liquidity could be the announcement of the wind-down of the ECB's Corporate Sector Purchase Programme (CSPP). While HY is not in scope of the purchase programme, the sector has benefited from a "portfolio rebalancing" effect. Rate hikes in the US, widening CDS spreads and falling equities markets appear furthermore to have had a knock-on effect on reduced EUR and GBP liquidity. Meanwhile, it seems probable that the volatility in GBP HY liquidity in Q4 is compounded by the increasing economic uncertainty stemming from Brexit.

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ICE Liquidity Trackers are designed to reflect average liquidity across global markets. The ICE Liquidity Trackers are bounded from 0 to 100, with 0 reflecting a weighted-average liquidity cost estimate of 10% and 100 reflecting a liquidity cost estimate of 0%. The ICE Liquidity Trackers are directly relatable to each other, and therefore, the higher the level of the ICE Liquidity Tracker the higher the projected liquidity of that portfolio of securities at that point in time, as compared with a lower level. Statistical methods are employed to measure liquidity dynamics at the security level (including estimating projected trade volume capacity, projected volatility, projected time to liquidate and projected liquidation costs) which are then aggregated at the portfolio level to form the ICE Liquidity Trackers by asset class and sector. ICE Data Services incorporates a combination of publicly available data sets from trade repositories as well as proprietary and non-public sources of market colour and transactional data across global markets, along with evaluated pricing information and reference data to support statistical calibrations.

# Repo and Collateral Markets

*by David Hiscock and Alexander Westphal*

## SFTR implementation

On 13 December, the European Commission adopted the long-awaited SFTR technical standards specifying the extensive reporting regime for SFTs which the law is set to introduce. The technical standards were adopted as a package, including three delegated regulations with Regulatory Technical Standards (RTS) and one implementing regulation setting out Implementing Technical Standards (ITS), including Annexes. Compared to the final drafts submitted by ESMA in March 2017, the versions now published include a number of relevant changes, including some amendments on substance which had been subject to further discussion between the Commission and ESMA who expressed their opposition to the changes in an opinion issued on 5 September.

While the content of the final standards still needs to be reviewed more thoroughly over the coming weeks, the fact that they have now been adopted finally provides more clarity in relation to the SFTR implementation timeline. In a first step, the RTS are now subject to scrutiny by the European Parliament and the Council. Both institutions have in principle three months (ie until 13 March 2019) to object, with the option to extend this period by another three months. Otherwise, the RTS will be deemed final, published in the *Official Journal* of the EU and will subsequently enter into force. However, the reporting rules will only apply after a further transition period of 12 months for banks and other investment firms (ie reporting "go-live" in April 2020), while other reporting firms, including CSDs and CCPs as well as buy-sides and non-financials will have between 3-9 months longer to prepare.

The adoption of the final technical standards also provides further momentum for the implementation work done by ICMA's SFTR Task Force set up under the European Repo and Collateral Council (ERCC). The group has been growing significantly over the course of 2018 and now includes around 100 member firms, covering the full breadth of the repo market: sell-side, buy-side, market infrastructures as well as the various service providers that are looking to develop solutions to facilitate SFTR reporting, including vendors and regulated trade repositories. Together with members of the Task Force, ICMA is working on agreed definitions and detailed best practices to facilitate the implementation of SFTR with the aim to incorporate these into the ERCC's existing *Guide to Best Practice in the European Repo Market*.

Another important objective is to continue the constructive dialogue with regulators on SFTR, in particular with ESMA who will have an important role to play in the implementation process. It is ESMA's task to provide additional guidance beyond the technical standards, as part of the so-called Level 3 process. While this process only starts once the technical standards have been finalised, ESMA has already indicated that it is planning to make extensive use of this possibility. Besides regular Q&As on

SFTR implementation, ESMA is planning to publish detailed Reporting Guidelines which aim to provide concrete examples and discuss different reporting scenarios. In anticipation of this work and in order to make sure that the ERCC's views are appropriately taken into account, the SFTR Task Force already submitted in December extensive early feedback to ESMA and will continue to actively engage with them on this important initiative. As part of this dialogue, Nikolay Arnaudov, senior policy officer at ESMA responsible for SFTR, joined the latest ERCC General Meeting held on 17 October in London to provide a detailed update on ESMA's ongoing SFTR work and to participate in a lively panel discussion with members of the ERCC's SFTR Task Force.

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## CSDR Settlement Discipline and SFTs

At its meeting in November 2018, the ICMA CSDR Settlement Discipline Working Group discussed the practicalities and potential challenges of applying the CSDR mandatory buy-in regime to repo and securities financing transactions (SFTs). Many of the considerations had already been outlined in the ICMA discussion paper, *CSDR Mandatory Buy-Ins and Securities Financing Transactions*. The objective of the working group is to seek industry-wide consensus on a number of proposals that it can share with ESMA. This is with a view to establishing regulatory guidance and market best practice to support successful implementation of the CSDR provisions.

Currently, buy-ins do not apply to SFTs, with the GMRA and GMSLA outlining alternative contractual provisions in the event of a settlement fail. Applying the CSDR mandatory buy-in framework to SFTs is not straightforward and presents a number of potential challenges and inconsistencies.

Topics discussed at the meeting included the treatment of "open trades", adjusting for haircuts when calculating the buy-in (or cash compensation) differential payment, and, as the greatest challenge, how to "buy-in" the start-leg of an SFT. Many of these issues remain unresolved and will require further deliberation by the working group and the broader SFT market.

Those interested in either following or participating in these discussions should contact the ICMA Secondary Market Secretariat.

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## Other regulatory reforms

On 18 October 2018, the BCBS published a consultative document (for comment by 16 January) entitled *Leverage Ratio Treatment of Client Cleared Derivatives*, which arises from a review of the leverage ratio's impact on banks' provision of derivatives client clearing services and any consequent impact on the resilience of CCP clearing. The BCBS seeks views on whether a targeted and limited revision of the leverage ratio's treatment of client cleared derivatives may be warranted.

Pending feedback provided in response to this consultation, the range of treatments that the BCBS may consider include: (i) no change to the current treatment; (ii) an amendment to the treatment of client cleared derivatives to allow cash and non-cash IM received from a client to offset the potential future exposure (PFE) of client cleared derivatives; and (iii) alignment of the treatment of client cleared derivatives with the standardised approach for measuring counterparty credit risk exposures, which would thus allow both cash and non-cash forms of IM and VM received from a client to offset the replacement cost and PFE amounts of client cleared derivatives. The BCBS also welcomes feedback on the merits of introducing a requirement for IM to be segregated in order for any amended leverage ratio treatment to apply; and views on forward-looking behavioural dynamics of the client clearing industry that might result from any amended treatment.

Also on 18 October, the BCBS published a statement on leverage ratio window-dressing behaviour. This recalls that the Basel III leverage ratio standard comprises a 3% minimum level that banks must meet at all times, a buffer for G-SIBs and a set of public disclosure requirements, for which purpose banks must calculate the leverage ratio on a quarter-end basis – although certain jurisdictions require banks to calculate the ratio more frequently (eg using averages of exposure amounts based on daily or month-end values). Heightened volatility in various segments of money markets and derivatives markets around key reference dates (eg quarter-end dates) has alerted the BCBS to potential regulatory arbitrage by banks – a particular concern is "window dressing", in the form of temporary reductions of transaction volumes in key financial markets around reference dates resulting in the reporting and public disclosure of elevated leverage ratios. This is unacceptable, and banks and supervisors should ensure ongoing compliance with the BCBS's leverage ratio.

Accordingly, in evaluating its leverage ratio exposure, a bank should assess the volatility of transaction volumes throughout reporting periods, and the effect on its leverage ratio requirements. Banks should also desist from undertaking transactions with the sole purpose of reporting and disclosing higher leverage ratios at reporting days only. Supervisors might also consider a number of actions to address concerns about potential window dressing activities. The BCBS will continue to carefully monitor potential window dressing behaviour by banks and will consider additional measures, including Pillar 1 (minimum capital requirements) and Pillar 3 (disclosure requirements).

Subsequently, on 13 December, the BCBS published, for comment by 13 March 2019, a consultative document entitled *Revisions to Leverage Ratio Disclosure Requirements*. This new consultative document seeks the views of stakeholders on revisions to leverage ratio disclosure requirements to include, in addition to current requirements, disclosures of the leverage ratio exposure measure amounts of SFTs, derivatives replacement cost and central bank reserves calculated using daily averages over the reporting quarter.

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## The GFMA and ICMA Repo Market Study

On 17 December, the GFMA and ICMA published a report, *The GFMA and ICMA Repo Market Study: Post-Crisis Reforms and the Evolution of the Repo and Broader SFT Markets*. This report has been written to provide an analysis and evaluation of the post-crisis assessment of the vulnerabilities in the SFT markets, the subsequent regulatory reforms and how the reforms have influenced the way the SFT markets function. It also highlights practitioners' views on potential future developments and vulnerabilities that may stem from regulation and other factors.

In many ways, the repo market represents the foundation stone of the financial system, vitally facilitating the flow of cash and securities across the system. More broadly, the SFT markets play a crucial and central role in the modern financial ecosystem, facilitating a number of critical functions and interacting with a variety of different financial markets and their users.

The post-crisis reforms have led to a financial system that depends on high-quality collateral that has low volatility and a high degree of liquidity as its foundation. The system has more concentrated inter-connectivity with derivatives clearing requirements, limited unsecured funding capacity and higher mitigation of counterparty risk, using collateral.

Therefore, it is imperative that the system has adequate capacity to move high-quality collateral – mainly through SFTs – across the system to where and when it is needed by market participants.

In recognition of the work undertaken by the CGFS, the Bank of England and US Treasury and understanding the fundamental importance of the SFT markets, GFMA and ICMA decided to provide an up-to-date view of the SFT markets from the industry viewpoint. As such, this is a contribution to the ongoing debate on whether these markets fulfil their economic functions as effectively as possible, given the multitude of constraints that have and are yet to be put in place as part of the post-crisis regulatory reform package as well as other markets regulations.

This report brings together a vast array of previous work across key themes and further adds to the existing research through a survey that was run among 33 senior practitioners, often heads of repo and collateral management desks across North America, Europe and Asia. It also includes quantitative assessment of the SFT minimum haircuts regime, which may lead to unintended consequences if the scope of transactions and counterparties is not further clarified in the yet to be implemented BCBS credit risk framework.

The report makes several recommendations to review the post-crisis regulatory framework, particularly pertaining to how it impacts the repo market, including:

The FSB and BCBS should review the coherence and calibration of the post-crisis regulatory framework, particularly pertaining to how it impacts the repo market. The treatment of repo transactions backed by the highest quality government bonds should be reviewed in order to ensure that the private sector market has the capacity to absorb QE unwind and to operate without significant reliance on central banks during normal and stressed market conditions.

The minimum SFT haircuts regime should be reviewed in line with policy objectives to address unregulated markets in order to avoid significant disruptions to the repo and securities lending market.

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## Repo and collateral-related research

Published on 2 October, *The Implications of Removing Repo Assets from the Leverage Ratio* is an ECB *Macroprudential Bulletin* article, which summarises the key findings from a counterfactual exercise where the effect of removing repo assets from the leverage ratio on banks' default probabilities is considered. The findings suggest that granting such an exemption may have adverse effects on the stability of the financial system, even when measures are introduced to compensate for the decline in capital required by the leverage ratio framework. Increases in probabilities of default are mainly seen for larger banks which are more active in the repo market. Moreover, it is observed that the predictive power of the model improves when repo assets are included. Overall, the analysis in this article does not support a more lenient treatment of repo assets in the leverage ratio framework, eg by exempting them or allowing for more netting with repo liabilities or against high-quality government bonds.

Central clearing of standardised derivatives and margin requirements for non-cleared derivatives are two of the basic tenets of global financial regulatory reform. They are also inter-related: the purpose of margin requirements is to both reduce systemic risk and promote or incentivise central clearing. Recent studies and research into clearing incentives and margining raise questions about whether certain aspects of the requirements do in fact support these key policy goals. Published on 17 October, *Clearing Incentives, Systemic Risk and Margin Requirements for Non-Cleared Derivatives* is an ISDA white paper, which analyses this topic and answers these questions.

Published on 30 October, *Variation Margins, Fire Sales, and Information-Constrained Optimality* is an ECB staff working paper. The authors note that protection buyers use derivatives to share risk with protection sellers, whose assets are only imperfectly pledgeable because of moral hazard. To mitigate moral hazard, privately optimal derivative contracts involve variation margins, and when margins are called, protection sellers must liquidate some of their own assets. The authors analyse, in a general-equilibrium framework, whether this leads to inefficient fire sales. If investors buying in a fire sale interim can also trade *ex ante* with protection buyers, equilibrium is information-constrained efficient, even though not all marginal rates of substitution are equalized. Otherwise, privately optimal margin calls are inefficiently high. Hence, they conclude that, to address this inefficiency, public policy should facilitate *ex ante* contracting among all relevant counterparties.

Published on 31 October, *The Morning After – The Impact on Collateral Supply After a Major Default* is an IMF staff working paper. Changes to the regulatory system introduced after the financial crisis include not only mandatory clearing of OTC derivatives at CCPs and margining of uncleared derivatives, but also prudential measures, including notably an LCR which obliges firms to set aside high-quality liquid assets (HQLA) as a stopgap against anticipated cash outflows. The authors examine factors which may affect the demand for HQLA in a severely stressed market following a hypothetical default of a major clearing member. Immediately following a major default, the amount of HQLA demanded by the whole market would spike. They estimate the size of the spike and draw conclusions as to whether the depth of the market is adequate to absorb it.

Published on 9 November, *Macroprudential Margins: a New Countercyclical Tool?* is a Bank of England staff working paper. The authors quantify the size of a fire-sale externality in the derivatives market in the absence of a macroprudential buffer on top of microprudential initial margin requirements; and show how this varies over the financial cycle with market volatility. They then assess the ability of a macroprudential buffer to reduce this externality, finding this depends critically on the release conditions of the buffer.

A buffer could reduce or, if set appropriately, even eliminate the externality, as long as it was released when investors faced any significant collateral calls, regardless of whether these related to variation or initial margins. However, it could be harmful if it was released only with calls for additional initial margin. Predicated on ideal release conditions, the authors test the performance

**Immediately following a major default, the amount of HQLA demanded by the whole market would spike.**

of macroprudential buffers based on anti-procyclicality mechanisms in current regulations. They devise alternative mechanisms that eliminate the externality, although it may be difficult for policy makers to specify these in practice.

Published on 19 December, *Re-Use of Collateral: Leverage, Volatility, and Welfare* is an ECB staff working paper. The authors assess the quantitative implications of collateral re-use on leverage, volatility, and welfare within an infinite-horizon asset-pricing model with heterogeneous agents. In their model, the ability of agents to re-use frees up collateral that can be used to back more transactions. Re-use thus contributes to the build-up of leverage and significantly increases volatility in financial markets. When introducing limits on re-use, they find that volatility is strictly decreasing as these limits become tighter, yet the impact on welfare is non-monotone. In the model, allowing for some re-use can improve welfare as it enables agents to share risk more effectively. Allowing re-use beyond intermediate levels, however, can lead to excessive leverage and lower welfare. So, the analysis in this paper provides a rationale for limiting, yet not banning, re-use in financial markets.

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## ERCC Guide to Best Practice in the European Repo Market

Following approval of a further set of updates to the ICMA ERCC *Guide to Best Practice in the European Repo Market*, at both ERCC and IRCC levels in accordance with the ICMA Rules, members of the ICMA ERCC were notified of the publication of the new, December 2018 version, effective 21 December.

Whilst tidying up some further minor details, this latest version of the Guide also introduces some elements of new, extended and refined best practice guidance. Examples include elements of best practice in relation to the margining of ex-dividend securities (4.12-4.16); instructing settlement (2.54-2.56); margin disputes (3.61); and manufactured payments (4.7-4.9). In addition, this latest version includes revisions to the first three annexes, mainly in the glossary (annex II).

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# Green, Social and Sustainability Bond Markets



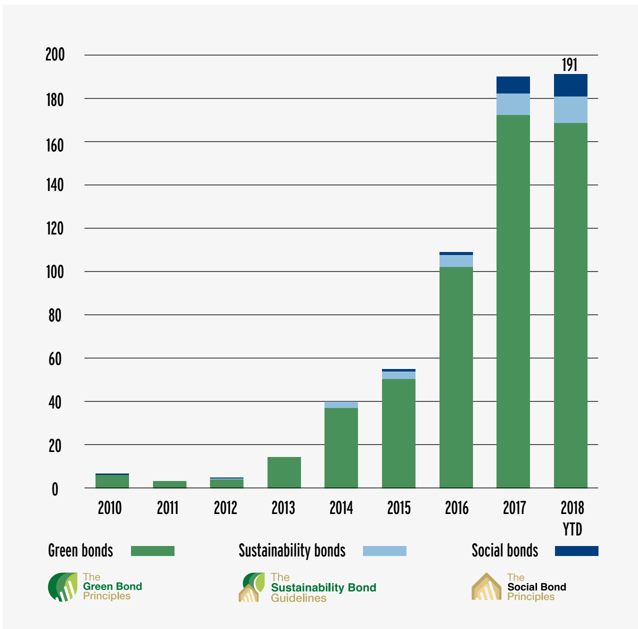
*by Nicholas Pfaff, Valérie Guillaumin and Peter Munro*

## Green, social and sustainability bond market developments

The green, social and sustainability bond market seems to have saved the best for the last quarter of the year in terms of debuts and market developments. After a lacklustre autumn with weak levels of issuance in October, November in particular delivered a remarkable USD31.5 billion, a record for monthly green bond issuance and representing an increase of 21% for the same period last year which held the previously highest issuance on record.

Cumulative issuance in the green bond market has now exceeded USD500 billion with around USD430 billion outstanding (source: Environmental Finance). As at second week in December 2018, year-to-date issuance is being reported as ranging from USD154 billion by Environmental Finance to USD168 billion according to SEB. Given the expected holiday lull over the final fortnight of the year, the market consensus is that total issuance volume for the year will be flat to 2017 owing to a number of factors not idiosyncratic to the green bond market but rather reflective of a dip in global EUR and USD bonds volume. This is in addition to perhaps some postponing from issuers awaiting the outcome of the European Commission's work on developing a taxonomy to be published.

***Green, social and sustainability bond issuance by type (USD billion)***

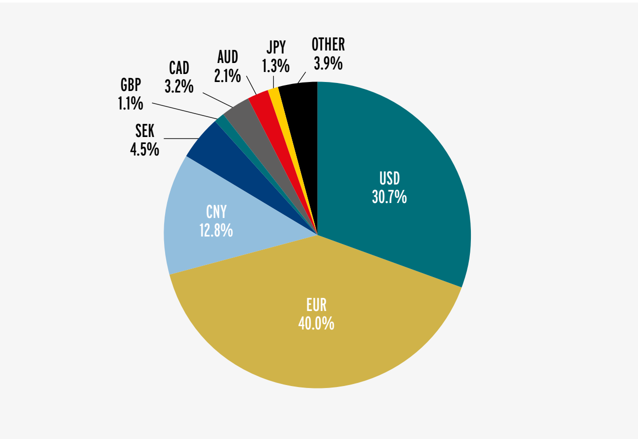



*Source: SEB analysis based on Bloomberg and SEB data*

Sovereign issuance continued to provide ample-sized transactions. In October, Ireland's EUR3 billion debut sovereign green bond accounted for over half of the month's issuance volume and brought the number to seven sovereigns having issued green bonds during the year. Other sovereign issues include France's EUR4 billion tap of the Green OAT 2039, the Kingdom of Belgium's EUR4.5 billion inaugural green bond, Poland's second green bond for EUR1 billion, Lithuania's EUR 20 million debut green bond and Republic of Indonesia's USD1.25 billion green sukuk. Also noteworthy is Seychelles' USD15 million 10-year "blue bond" which raised funds to protect marine life. The bond was structured similarly to a use of proceeds sustainability bond. Most recently, the Netherlands announced plans to raise between EUR4-6 billion in green bonds in the first half of 2019. It would be the first AAA-rated sovereign green bond. Green bonds served as a relatively appealing funding option during periods of market volatility in the last quarter of 2018. At one point in October, new issuance of green bonds outnumbered vanilla bonds in the primary market.

In the green bond market, the US remains the top issuing country with around USD33.6 billion of issuance this year, most of which is in the form of green securitised debt and the rest mainly from a handful of corporates and over 50 municipalities. China takes second place while France, Germany and the Netherlands close out the top five issuing countries. Euros remain the largest issuance currency in the green bond market, mainly owing to corporates favouring euro issuance as well as jumbo sovereign issues.

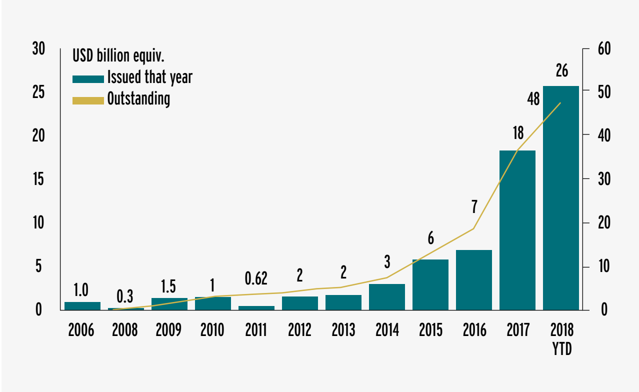
***2018 YTD Green bond issuance by currency***




*Source: SEB analysis based on Bloomberg and SEB data*

On the social and sustainability bonds front, combined issuance as at 14 December is reported as USD26 billion for the year to date, up from USD18 billion in 2017 and an impressive 3.7x the volume in 2016 (source: Bloomberg and CACIB). Outstanding issuance on that basis now sits at USD48 billion.

***Social and sustainability bond issuance***




*Source: Bloomberg, Crédit Agricole CIB Sustainable Banking (As of December 14th 2018)*

Looking more broadly, there is an emerging trend in the growth of procedures to connect financial policy and regulation with sustainability. The UNEP Enquiry reported in its publication over the summer that, between 2013 and 2017, the number of sub-national and national-level policy and regulatory measures doubled from 131 in 43 jurisdictions to 267 in 53 jurisdictions. In addition, international advances to encourage sustainable finance have quadrupled: In 2013, there were just eight such measures which by 2017 had grown to 33. In that context, it is interesting to acknowledge that 53 Jurisdictions have now seen green bond issuance since the inaugural issue. SEB report that in 2018, year-to-date, 45 jurisdictions have registered issuance which is up from 42 in 2017.

In October, the IPCC published its latest report and significantly changed its focus from limiting global warming at 2°C to 1.5°C, thus encouraging more urgent action from policy makers and governments. The report also considered synergies between the 1.5°C target and the UN's Sustainable Development Goals (SDGs). We expect this may positively impact both investor and issuer interest in green, social and sustainability bonds, also bearing in mind the recent mapping of the Principles' use of proceeds categories to the SDGs. The growing number of initiatives, promoting inclusion of climate risks and wider ESG in finance, supports the evolution of the sustainability bond market.

2018 has also been characterised by product innovation, with the expansion of sustainable finance across capital markets and sustainability criteria being incorporated into products such as loans – including transactions aligning with the Green Loan Principles, as well as mortgages, covered bonds and derivatives. Where underlying assets are refinanced by bonds aligned with the Principles, this broadens the foundations of the green, social and sustainability bond markets.

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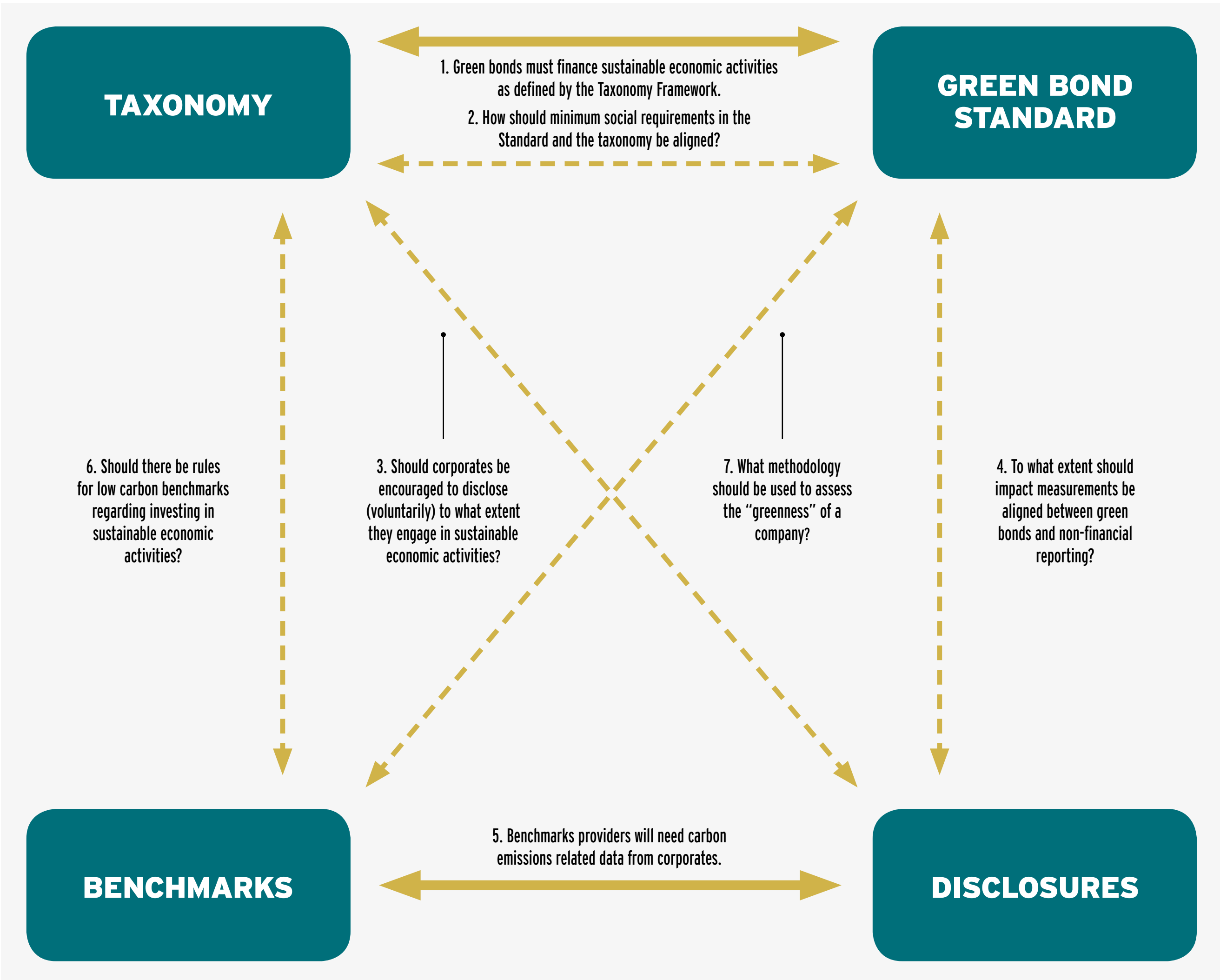
## European Technical Expert Group on Sustainable Finance

Following the publication in March 2018 of the Action Plan on Sustainable Finance of the European Commission, the Technical Working Group on Sustainable Finance (TEG) was established in June 2018. ICMA, represented by Nicholas Pfaff, was nominated on the TEG with the support of the Green Bond Principles & Social Bond Principles Executive Committee following a highly selective process. The TEG has held monthly working group and plenary meetings since its inception and its mandate will run until 30 June 2019, with possible extension until the end of 2019.

The TEG is working on four key deliverables: (i) an EU taxonomy of environmentally sustainable economic activities; (ii) an EU Green Bond Standard; (iii) a category of "low carbon" indices for use by asset and portfolio managers as a benchmark for a low carbon investment strategy; and (iv) metrics allowing improved disclosure of climate-related information. As illustrated below, these different workstreams are designed to be mutually supportive with, for example, the Green Bond Standard referring to the Taxonomy, while providing a definition of a key green asset to be included in corporate reporting under the recommendations for disclosures and incorporated in the proposed sustainable benchmarks for indices.

***Linkages between the four TEG subgroups***

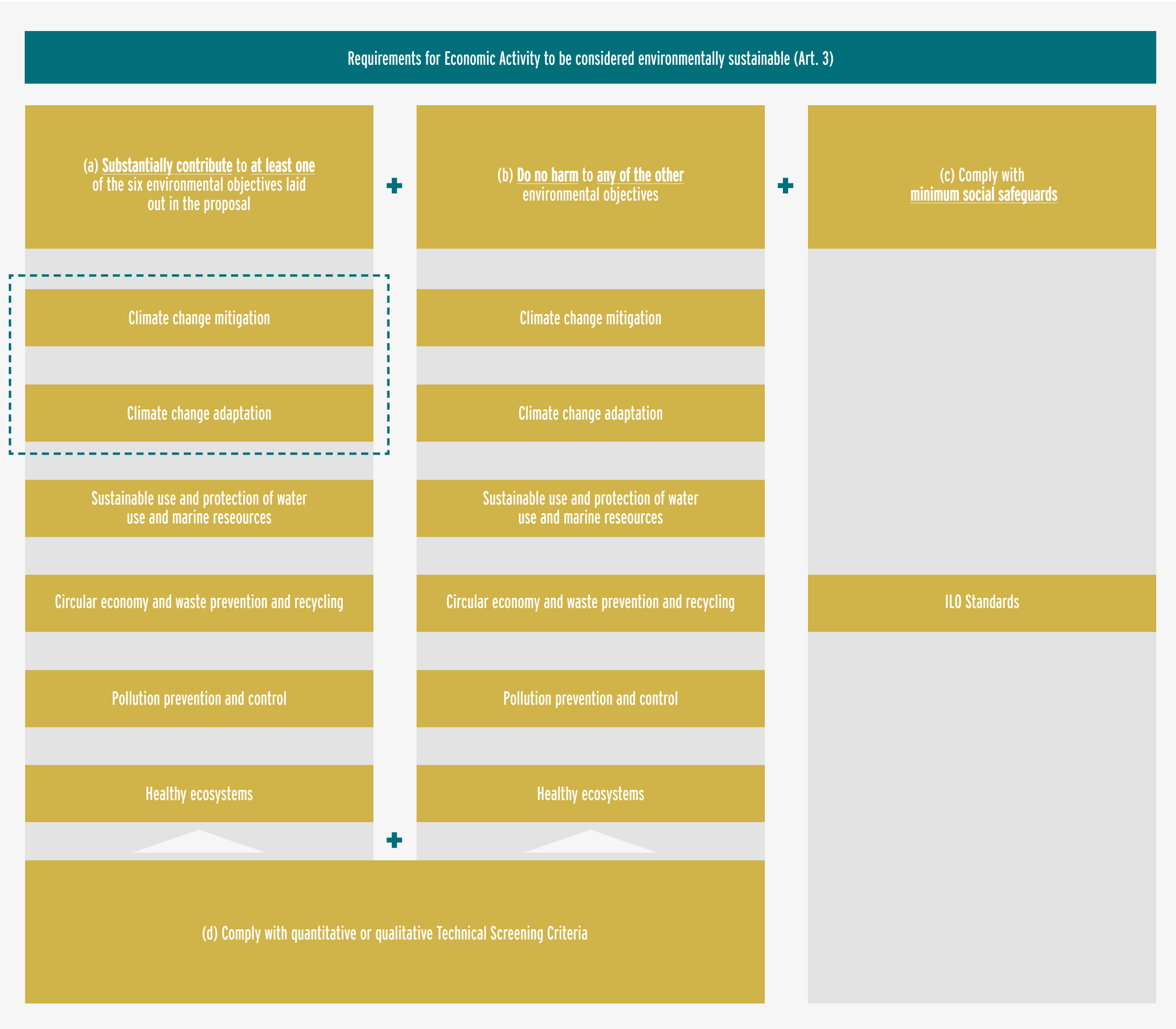


The TEG had made good progress on all these fronts and is consulting widely with stakeholders through dedicated stakeholder meetings, as well as public consultations. In that respect, it is important to note that the consultation on the Sustainability Taxonomy is now online and open until 22 February. This consultation relates to the first draft of the climate mitigation taxonomy, as well as more generally on its usability. ICMA will be responding to this consultation.

The future Sustainability Taxonomy identifies high-level sustainable economic activities based on existing EU statistical categories (see NACE). These sustainable activities need to (i) substantially contribute to at least one of the EU's six environmental objectives while (ii) not conflicting with any of these objectives and (iii) complying with minimum social safeguards. The Taxonomy also provides impact metrics and minimum thresholds. The latter represents a key development for future market practice. Generally, the Taxonomy has the following characteristics:

- it focuses not only on purely green sectors, but also sets thresholds to enable the greening of polluting sectors;
- it is dynamic as it will be kept up to date taking into account the latest policy and technological developments and innovation;
- it is built as much as possible on existing initiatives;
- it is non-binary as activities that are not on the list are not necessarily "brown" or polluting activities;
- it is granular enough to minimise ambiguity about "greenness" of an activity and flexible enough to cater to technological and market developments.

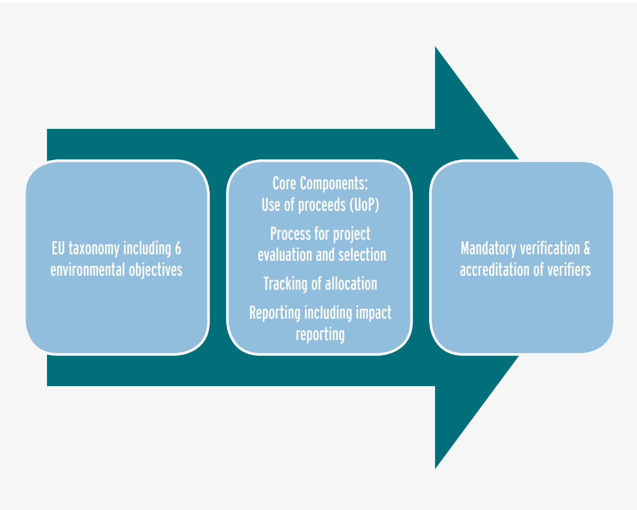
***Taxonomy – Which economic activities will qualify?***



**As the EU Taxonomy will be rolled out progressively, there is a discussion on how it may co-exist temporarily or more permanently with existing GBP categories and market based taxonomies.**

As the Taxonomy will be rolled out progressively, there is a discussion on how it may co-exist temporarily or more permanently with existing GBP categories and market-based taxonomies (eg CBI). The outcome that we are supporting is that going forward the market continues to be able to refer to these existing references where the Taxonomy may not be comprehensive or sufficiently interpretable as long as projects (i) align with EU environmental objectives and (ii) are validated by an EU accredited verifier.

***Key features of the Green Bond Standard***




The stated objectives of the EU Green Bond Standard (GBS) are to further protect the integrity of, and trust in, the green bond market by giving detailed guidance to issuers as well as enabling wider access for investors seeking such a product. Based on discussions to date, the key aspects of the GBS can be described as follows:

- It is designed as a voluntary standard that will co-exist with the guidance provided by the GBP.
- It is being positioned as both a European and international standard.
- To qualify, green bond transactions or programmes will need to be verified by accredited external reviewers.
- Proceeds will need to be consistent with the EU taxonomy.

It is important to underline that two other Commission initiatives could impact the green bond market. The first would be minimum disclosure requirements for green bonds through amendments to the EU prospectus regime. We are questioning whether such a regulatory initiative is necessary in light of the transparency of existing market practice in this area and the risk of creating additional cost and crystallising additional liability for issuers. There are also discussions on an Ecolabel for financial products that could cover green bonds. We believe that such an approach may be feasible for funds on the model for example of the TEEC label in France but would not be practical for bonds as (i) it could overlap with the EU GBS and (ii) it is likely to be complex and impractical to implement.

The work on the low-carbon benchmarks is focused on selection criteria, data needs, and weighting methods for underlying assets of such benchmarks. The proposed low-carbon benchmark (LCB) would be used for risk diversification and would be aligned with the Paris agreement. The positive carbon impact benchmark (PCIB) would be used for investing with impact (but, would not be aligned with the Paris agreement). Both proposed benchmarks raise technical challenges and there are ongoing consultations with stakeholders.

The TEG's work on disclosures aims to complement and update the non-binding guidelines of the Non-Financial Reporting Directive (NFRD) by incorporating climate-related disclosures. The objective is to build on and further develop the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The group has taken up the challenge of identifying disclosure metrics that could give meaningful information about the impact a company has on climate change. Both climate change mitigation and adaptation are part of the scope. Wide consultations on the proposals for disclosures should take place in Q1 2019.

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# Green, social and sustainability bond markets: ICMA events and education

ICMA recognised early on that the green, social and sustainability bond markets were rapidly internationalising and would benefit from supporting initiatives. Specifically, ICMA identified opportunities for deployment of its well-established events and, in a second step, its executive education capabilities, supported by its existing partners and members on the ground. The aim was to accelerate awareness and understanding, as well as providing practical skills for those wishing to enter or grow their role in the market.

Over the past two years there has been a decisive expansion of ICMA and Green Bond Principles & Social Bond Principles' (the Principles) events from Europe to Asia in support of the market's growth pattern. The first two years of the Green Bond Principles (2014-2015) were dominated by issuance and developmental support from market participants in Europe and to some extent the US. Consequently, the flagship annual meeting of the GBP was held in Europe.

The surge in green bond issuance in China in 2016, supported by official guidance closely following key aspects of the Green Bond Principles (issued in late 2015), naturally drew attention and confidence in the potential for this market and Asia more generally. A further major signal of new momentum in Asia came from Japan in H1 2017, with publication by the Ministry of Environment of guidelines for green bonds, building on the Green Bond Principles, which was soon followed by an uptick in local issuance.

With the Chinese market already advancing strongly under its own steam, ICMA responded to these signals by proposing a major conference on green, social and sustainability bonds in Japan to offer timely insights on the emerging potential for the Japanese market, but also the wider Asian markets. This idea found immediate support from ICMA's longstanding local partner, the Japanese Securities Dealers Association. It was further boosted by the publication later in the year of the ASEAN Green Bond Standards, developed in close partnership with ICMA and the Principles' Executive Committee.

This inaugural event in Tokyo in November 2017 was substantially over-subscribed, with a full house of some 400 attendees and an array of prominent speakers from leading Japanese and international firms and the official sector. This vindicated the initiative and led to a recent repeat in December 2018, with attendance growing substantially to over 500 participants, and attracting increasingly senior speakers, against a backdrop of a doubling of issuance of green, social and sustainability bonds in Japan. Given the highly favourable reception for the conference, it was announced that ICMA and JSDA plan to repeat the event in 2019.

Meanwhile, the Principles' Executive Committee and ICMA were also exploring means to address and support the great interest in China. A pioneering proposal from the Hong Kong Monetary Authority (HKMA), to host the 2018 Principles AGM and Conference in the Hong Kong SAR of China, was therefore very warmly welcomed. The favourable market backdrop in China, strong vision of HKMA's leadership, and accelerating Hong Kong official support for green bonds - via plans for sovereign bonds and boosting external review capabilities and incentives, provided an excellent platform. It proved to be an outstanding partnership with ICMA and the Principles' Executive Committee. The 2018 AGM and Conference attracted record registrations (over 800), and a remarkable week of complementary events. These included an HKMA-PBoC conference on sustainable finance in China, as well as large scale meetings of the Principles' Working Groups and the Official Sector Contact Group.

The dates for the next AGM and associated events have been set for the week of 10 June 2019, and will be held in Frankfurt, Germany. Such a European location seemed appropriate, to recognise the continued role of the EUR market as a global leader (issuance in EUR has led in terms of volume this year) and to acknowledge the importance of the sustainable finance initiatives under the aegis of the European Commission's Technical Expert Group - of which ICMA and several GBP/SBP Excom firms are members, as well as German initiatives to scale up green and sustainable finance activities. In particular, the forthcoming 2019 GBP/SBP AGM in Frankfurt is made possible by the generous support of a new association - the Green and Sustainable Finance Cluster Germany. It is important to note that in line with the importance of US issuers in the green, social and sustainability bond market, one or more events are under consideration in Washington and/or New York in 2019.

Executive education can play a key role in promoting development of an efficient and effective green and social market. In its last Quarterly Report, ICMA reported on the launch of a new training course, *Introduction to Green Bonds*, in Q1 2018, dedicated to green, social and sustainability bonds. ICMA's aim was to address a perceived gap in the market, by offering the first comprehensive executive education course catering to all types of debt market practitioner, as well as service providers and official stakeholders in the green and social bond markets. Recognising additional interest in targeted courses, in-house and tailor-made courses were also on the agenda. The approach built on ICMA's well-established executive education platform, with over 40 years of experience, as well as its experience from hosting the platform for the Green Bond Principles & Social Bond Principles. As with other ICMA education services, these remain not-for-profit initiatives, and revenues are purely put towards ICMA operating costs.

In the last few months ICMA continued to widen the reach and evolve the approach. In H2, inaugural events were held in South East Asia and Japan, including the first in-house and tailor-made courses for issuers. Overall in 2018, these courses have reached some 300 executives through courses held in Europe and Asia.

The Green Bonds Course has this year become a standard complement to relevant conferences, such as the ICMA regional events and GBP/SBP AGM described above. A course prior to the last AGM in Hong Kong, supported by the Hong Kong Business Environment Council, attracted a broad range of local issuers and market participants. Also, a course was held in Tokyo just before the recent December conference, co-hosted by JSDA and enjoying generous buy and sell-side sponsorship. This event was oversubscribed, attracting a range of leading issuers, investors, intermediaries and service providers.

In addition, an innovative partnership was developed with IFC, with generous support from the Swiss authorities. This has introduced the first courses with a sectoral emphasis (green buildings), combined with a focus on supporting capacity for issuance in emerging markets. The over-subscribed inaugural courses were held in Singapore, boosted by an MoU between by IFC and the Monetary Authority of Singapore. Further iterations are expected in 2019 in new locations - IFC is already preparing events in South East Asia for Q1 2019, with other regions to follow. It forms part of a wider initiative by IFC's Financial Institutions Group, addressing both the demand and supply side of the green bond market. The initiative gained strong attention after IFC boosted demand for EM green bonds by launching the largest EM green bond fund earlier this year (US$1.4 billion), with Amundi appointed as asset manager.

In 2019 ICMA plans to scale up further, and also to diversify the locations for public training courses. The first course of the new year will be in London on 11-12 February, and other locations are planned in Europe and beyond. To find out more about ICMA's activities in green and social bond education and partnership opportunities, please initially write to greenbonds@icmagroup.org.

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# Asset Management

*by Patrik Karlsson and Bogdan Pop*

## MiFID II: second AMIC FICC research unbundling survey

Following the success of the first AMIC FICC research unbundling survey conducted in October 2017 and at the suggestion of the AMIC Executive Committee, the AMIC Secretariat has issued a second survey to assess the implementation of the MiFID II research unbundling rules.

The purpose of the second AMIC FICC research unbundling survey is to assist our members understand their peers' views on research unbundling and to establish progress compared to the first survey. More specifically, the survey asked how firms have implemented the rules, whether the market for research has settled and in what respects firms still have difficulties with the rules.

The results of the survey were published at the AMIC Conference on 22 November 2018.

### General questions and state of play

28 firms responded to the survey, of which 93% were asset management firms. Geographically, the majority of respondents were based in the UK (39%) and Germany (21%). The remainder were from France, Switzerland, the Netherlands and other countries within the EU. 75% of respondents said they found it difficult to decide what research needs to be paid for and what can be considered minor non-monetary benefits (MNMB). Despite this, only 43% said they have not received enough guidance from their national regulator or ESMA – down from 52% the year before.

As expected, the majority of respondents (71%) said they already have written contracts or agreements in place with all the FICC research providers they use. In respect of blocking unsolicited research, the vast majority, 86%, have taken a pragmatic approach by providing training and relying on manual reporting by employees. Some firms have augmented this process via selected permissions on market terminals (32%) and automatic IT solutions blocking unauthorised providers (14%).

### Specifics on paying for FICC research

Following the market trend which emerged last year and which was also noticed in our last survey, 79% of respondents said they are paying for research via their P&L. This was 67% in last year's survey.

Discussing the style of pricing that firms have signed up for, 68% of respondents said they are using "all you can eat" type agreements. 43% said they are using a fixed cost agreement with additional consumption in excess of a certain limit charged extra. Only 7% have signed up for menu pricing agreements, a type where a firm pays per each item.

Most respondents (82%) said that they are using a small number of research providers. In last year's survey, 83% said the same.

The majority of respondents (68%) said that they use less FICC research from all providers, while a minority (28%) said their consumption has not changed. Overall independent research providers do seem to get a larger slice out of the shrinking pie, which is in line with our survey results from 2017.

### Impact on quality, performance and in-house research

The vast majority of respondents said that the quality of FICC research has not changed. 86% said this in respect of research from banks/brokers, while everybody agreed when referring to independent research providers. This marks a shift from last year's expectations, where 32% of participants said that they believed research will get worse, while 14% said they believed it will get better.

When asked how a firm establishes the value of research and how it establishes that this meets the objectives of the fund, the majority of respondents (64%) said that this is mainly decided by the fund manager and analysts, while broker voting is also used to make a decision by 46% of respondents. Unsurprisingly, the vast majority of respondents (86%) do not think that the reduction in FICC research providers used will have any negative impact on fund performance.

In respect of in-house research, the majority (82%) said they do not intend to, or have not increased, their in-house research capacity because of the new rules. This majority has widened since our 2017 survey when 68% of respondents said the same.

When asked about the availability and breadth of SME research, 57% said that they have not noticed a decrease. But it is interesting that 43% of respondents did notice a decrease less than a year after implementation. We expect this trend to continue as the reforms bed down.

### *Impact on market practices*

In respect of investor roadshows, a small majority of respondents (54%) said that they have changed their attitude to these as a result of new rules. The majority (65%) of these said that the reason for the change relates to difficulties in deciding which type of roadshows can be considered MNMB and which need to be paid for.

82% of respondents said that they are comfortable to use research which is made openly available to all investment firms on the website of a research provider. Also 82% of respondents said that they would be comfortable to use free trial periods as specified in the ESMA Q&A at some point in the future.

### *Impact of rules on non-EU FICC research*

Respondents' approach to tackling the conflicting rules around FICC research globally seems to be equally split between unbundling research fees globally (35%) and segregating the EU and non-EU businesses (35%).

Our 2017 survey showed that the majority (64% of firms) were planning to unbundle globally and only 7% of firms were planning to segregate EU and non-EU businesses. The significant change in firm attitude to the business segregation model may reflect that, for some firms, the costs and complexities of segregating their businesses geographically outweigh the costs and complexities that come from unbundling globally.

Some firms, however, have applied the new rules on research more widely than just within the EU. 54% of our respondents said they applied it within the EEA, 21% said they applied it to US/Canada, Asia (including Japan) and Australasia.

In respect of the application of the rules to UCITS/AIFM management companies, 57% of respondents said that they extended the new research rules to these entities as well to avoid different rules applying to parts of the same asset management groups.

Depending on the state of the market for research and the view of our membership on this topic in 2019, AMIC may re-run the survey to assess further developments in the implementation of the MiFID II unbundling rules. AMIC would like to once again thank all the firms who responded to our survey for their contribution and time.

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## Covered bond legislation

The Covered Bond Investor Council (CBIC) has kept its members up to date on the various developments over the past few months on the European Commission's proposal for a Directive and Regulation on covered bonds. Two important developments took place in late November to spur more progress in the inter-institutional negotiations.

On 19 November the European Parliament's Economic and Monetary Affairs (ECON) Committee voted and approved their reports on the covered bond Directive and Regulation. The final reports were published on 26 November. Regarding the Directive, MEPs ended up compromising on the key priorities among the political groups. Extendable maturities amendments by *rapporteur* Bernd Lucke MEP (ECR, Germany) were transformed into a requirement that the Commission must issue a study on the risks involved in the future. This came in exchange for key amendments on the European Secured Note (ESN) being dropped, becoming instead a commitment by the Commission to review the need for legislation on ESNs in the future. However, key parts of previously tabled amendments by the *rapporteur* and other MEPs remain in the final ECON text, notably the *rapporteur's* plans to split covered bonds into "premium" and "ordinary", depending on underlying assets.

Separately, the Council has also adopted its general approach, covering both the Directive and the Regulation. The Council also published the texts on 26 November. It is worth pointing out that the Council has chosen a less incisive change to eligible assets than the Parliament, opting to tighten the conditions around "other high quality assets" to remove some discretion from Member States.

Now that both the Parliament and Council have adopted their positions, trilogue negotiations could begin with a view to agreeing a compromise text between the European Commission, Parliament and Council before March 2019.

The CBIC Secretariat analysed the two texts and suggested preferred investor positions on key issues like eligible assets, investor information, extendable maturities, third country equivalence and liquidity buffers.

The Article on eligible assets is crucial for investors. CBIC supports a high-quality European covered bond product that should be safeguarded in the legislation. CBIC does not support the proposals to differentiate "premium" and "ordinary" covered bonds. Such a bifurcation risks damaging the reputation of the covered bond brand. For this reason, the Council text limiting assets to Article 129 CRR assets and creating conditions for any other assets is preferable to investors.

CBIC noted that there was some tinkering with the investor information requirements in Article 14. While the original Commission proposal did not refer to it, CBIC is strongly supportive of the Harmonised Transparency Template (HTT) produced by the ECBC in cooperation with investors. Given the high standard of disclosure in the HTT, it is disappointing that the ECON text would decrease the frequency of investor disclosure from quarterly to bi-annual. The Council proposal, adding detail and keeping the frequency, is preferable to investors.

However, on maturity extensions, the CBIC supports the ECON proposal to study the effects of maturity extensions and to amend legislation at a future date when more is known about their effects. Meanwhile, the most important aspect of the Commission's proposal is how the maturity extensions are triggered. Investors believe there should be no discretion for the issuer to trigger an extension, which the ECON text addresses better than the Commission or Council.

Finally, on third country equivalence, the ECON text removes any delay to the Commission's power to find third countries' covered bonds regimes equivalent. This is supported by investors, who do not agree with a two (Council) or a three (Commission) delay until equivalence decisions can be made.

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## AMIC Primary Market Investor Working Group

The latest meeting of the AMIC Primary Market Investor Working Group (PMIWG), established in June 2018, was on 19 November. The working group was set up to allow buy-side members access to ICMA's primary market expertise and to provide a forum where market practices can be discussed among investors, syndicate managers and issuers. The meeting on 19 November brought together the buy-side members of the working group as well as representatives from the ICMA Primary Market Practices Committee (PMPC) and representatives from the ICMA Corporate Issuer Forum (CIF) to discuss current market practices surrounding "announcement terms" and how these can be improved for the benefit of all.

The AMIC working group has been considering "announcement terms" throughout its three meetings, having discussed the details of a deal which are disclosed at the time of announcement when books open. Asset managers and other buy-side participants are required to make quick decisions based on these terms as to whether to attempt to invest in this new issue or not, as internal processes and procedures (entering data into order management systems, seeking compliance checks and approval, etc) often take time. Once investors consider a particular new issue, they then need to undertake intensive research to find minor but critical details relating to that deal, such as the domicile of the issuer and the guarantor, seniority or coupon type. As these details are not easy to find, investors are often not able to focus on several deals at once if they are announced on the same morning. So new issues are not always reaching the full investor spectrum due to the lack of standardised disclosure of minor but critical information. During previous PMIWG meetings, investors raised these issues and consequently the PMIWG created a draft list of announcement terms which would help address these concerns.

At the 19 November meeting, investors discussed with representatives of underwriters and issuers whether there is room for at least some of these terms to be included in standard deal announcements. The response was that this was possible and something that underwriters had worked on in the past to improve but were unable to obtain a buy-side view to confirm whether these improvements would be worthwhile.

Participants discussed the technical aspects of announcement terms, including the definition, use and examples of each of the draft announcement terms proposed by the PMIWG. Discussion also covered some additional terms proposed by the underwriter representatives, including TEFRA status, MiFID II and PRIIPs status and other selling restrictions.

There was constructive discussion and wide agreement on a number of terms, while on some other terms it was agreed that standardisation would be very difficult, eg industry type, country of risk, seniority. The secretariats of the PMIWG and PMPC agreed to produce a new version of the announcement terms based on the discussion. The issuer representative who participated in the meeting welcomed the open discussion between the underwriters and investors.

Participants also briefly discussed the importance of ISIN availability at deal launch, as this topic had already been addressed at the previous meeting on 5 September.

The next step on announcement terms is for the PMIWG to organise a discussion with technology providers, such as data vendors. Such a discussion would leverage the work done by ICMA on mapping FinTech solutions.

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# International Regulatory Digest

*by David Hiscock and Alexander Westphal*

## G20 financial regulatory reforms

On 22 October 2018, the FSB Plenary met in Ottawa. The Plenary discussed market developments and vulnerabilities in the global financial system, including consideration of the risks that could be particularly relevant if a snap-back in interest rates were to occur. Plenary members highlighted that authorities should consider using the current window of opportunity to build resilience, particularly macroprudential buffers where appropriate. The increasing role of non-bank financial intermediation (NBFI) underscores the importance of work being taken forward by the FSB and other standard-setting bodies (SSBs) to better understand how new market structures could respond to, and transmit, shocks, and of implementing the FSB's recommendations to address structural vulnerabilities arising from asset management activities.

The Plenary discussed and endorsed the following reports for publication in November and delivery to the G20 Summit:

- the fourth *Annual Report on Implementation and Effects of G20 Financial Regulatory Reforms,* which describes the progress made in implementing post-crisis reforms, the effects and effectiveness of those reforms, and areas of focus going forward;
- the evaluation of incentives to centrally clear OTC derivatives, which was conducted jointly by the FSB and other SSBs, responsive to which relevant SSBs are considering particular standards or policies that may need to be adjusted – with the BCBS already having issued, on 18 October, a public consultation setting out options for adjusting, or not, the leverage ratio treatment of client cleared derivatives;
- the evaluation on infrastructure finance (the first part of a broader evaluation of the effects of reforms on financial intermediation), which finds that G20 reforms have been of second order relative to other factors;
- a progress report on its coordinated action plan to assess and address the risks from the decline in correspondent banking relationships;
- the *Cyber Lexicon* to support the work of the FSB, SSBs, authorities and private sector participants in their work on cyber security; and
- a discussion paper setting out considerations for evaluating the adequacy of financial resources for CCP resolution and the treatment of CCP equity in resolution, which takes forward the final important piece of policy development to address the resilience, recoverability and resolvability of CCPs.

Plenary members concluded their review of the FSB's processes and transparency and agreed on a set of measures to ensure its continued effective operation and further enhance its focus and ability to promote financial stability. Separately, the Plenary approved a framework for collection and handling of non-public firm-level data, for use in cases where data is not more efficiently available through public sources. Plenary members also reaffirmed the importance of regulators having access to data required to carry out supervisory and enforcement mandates while maintaining regard for data privacy.

Furthermore, Plenary members discussed the main elements of the FSB work programme for 2019 and future years, including potential deliverables to the G20 in 2019 during the Japanese Presidency (the FSB will publish an overview of its work programme once a final version has been agreed by the Plenary). The work programme will focus on (i) finalising and operationalising post-crisis reforms; (ii) monitoring the implementation and evaluating the effects of post-crisis reforms; and (iii) addressing new and emerging vulnerabilities in the financial system. Specific new initiatives include:

- an evaluation on the effects to date of reforms to end too-big-to-fail (TBTF), which will be launched in early 2019 and completed in 2020;
- an initiative to explore ways to address the risk of market fragmentation;
- a project on financial stability implications of decentralised financial technologies; and
- a project to develop effective practices relating to a financial institution's response to, and recovery from, a cyber incident, on which a progress report will be published by mid-2019.

Finally, Plenary members received updates about ongoing workstreams including:

- work by IOSCO to finalise its consultative report on leverage measures for funds, to be published before the G20 Summit, which operationalises one of the FSB recommendations to address possible structural vulnerabilities from asset management activities;
- work by the OSSG to coordinate the transition to risk-free rates in a number of currency areas, and thus to transition away from LIBOR;
- progress by the IASB in addressing implementation and auditing issues related to the 2017 international standard on insurance contracts, IFRS 17; and
- the work of the FSB's TCFD, which published a status report in September on companies' adoption of its recommendations, and will publish a further status report in June 2019.

On 26 October, the BCBS issued the *Fifteenth Progress Report on Adoption of the Basel Regulatory Framework*, which sets out the adoption status of Basel III standards for each BCBS member jurisdiction as of end-September 2018 – inclusive of the finalised Basel III post-crisis reforms published in December 2017, which will take effect from 1 January 2022. Since the last report published in April 2018, member jurisdictions have made further progress in implementing some standards whose deadline has already passed or is within the next six months. However, the report also shows that limited progress has been made on the implementation of other standards whose implementation deadlines have passed – notably the NSFR, for which only ten BCBS member jurisdictions have final rules in force.

On 15 November, the FSB published its *2018 Resolution Report* and also launched for public consultation, for comment by 1 February 2019, a discussion paper on financial resources to support CCP resolution and on the treatment of CCP equity in resolution. The report updates on progress in implementing the framework and policy measures to enhance the resolvability of SIFIs and sets out the priorities for the FSB's resolution work going forward. The report finds that jurisdictions have undertaken substantial reforms to mitigate the TBTF problem. Implementation is most advanced in the banking sector where most home and key host jurisdictions of G-SIBs have introduced resolution regimes that are broadly aligned with the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions* and have launched their resolution planning for G-SIBs. However, for insurance companies and CCPs progress is less advanced.

Starting early in 2019, the FSB is going to evaluate the effects of the TBTF reforms in order to determine whether they are achieving their objectives and whether they have had any material unintended consequences – this evaluation will be completed in 2020. Additionally, the FSB has concluded that further guidance on the financial resources needed by CCPs should be developed in an evidence-based way, including by drawing on the practical experience gained from resolution planning by relevant authorities and Crisis Management Groups. To inform this process, the FSB's discussion paper sets out considerations that may be relevant to evaluating whether existing financial resources and tools are adequate to implement resolution strategies for individual CCPs; and considerations that could guide authorities in developing possible approaches to the treatment of CCP equity in resolution.

On 16 November, the FSB published the 2018 list of G-SIBs, using end-2017 data and an assessment methodology designed by the BCBS. One bank (Groupe BPCE) has been added to the list and two banks (Nordea and Royal Bank of Scotland) have been removed from the list and therefore the overall number of G-SIBs decreases from 30 to 29. Alongside this, the BCBS published updated denominators used to calculate banks' scores and the values of the underlying 12 indicators for each bank in the assessment sample. The BCBS also published the thresholds used to allocate the G-SIBs to buckets, as well as updated links to public disclosures of all banks in the sample. A new list of G-SIBs will next be published in November 2019.

Additionally, on 14 November, the FSB welcomed the publication of the IAIS consultation document on a proposed holistic framework, for implementation in 2020, for the assessment and mitigation of systemic risk in the insurance sector. This sets out the activities-based approach for sector-wide risk monitoring and management, as a key component of the framework, and tools for dealing with the build-up of risk within individual insurers. The FSB notes that a new holistic framework, appropriately implemented, would provide an enhanced basis for mitigating systemic risk in the insurance sector. In light of the progress with the proposed holistic framework, the FSB, in consultation with the IAIS and national authorities, has decided not to engage in an identification of G-SIIs in 2018; and will assess the IAIS's recommendation to suspend G-SII identification from 2020 once the holistic framework is finalised in November 2019. In November 2022, the FSB will, based on the initial years of implementation of the holistic framework, review the need to either discontinue or re-establish an annual identification of G-SIIs by the FSB in consultation with the IAIS and national authorities.

**The effect of the G20 reforms on infrastructure finance has been of a second order relative to factors such as the macro-financial environment, government policy and institutional factors.**

On 20 November, the FSB published its final report on the *Evaluation of the Effects of Financial Regulatory Reforms on Infrastructure Finance*, following public consultation earlier this year (in respect of which an overview of responses has also been published) – which focuses on infrastructure finance that is provided in the form of corporate and project debt financing (loans and bonds), for which the financial regulatory reforms are of most immediate relevance. The report concludes that the effect of the G20 reforms on infrastructure finance has been of a second order relative to factors such as the macro-financial environment, government policy and institutional factors. In particular, for the reforms that have been largely implemented and are most relevant for this evaluation – namely, the initial Basel III capital and liquidity requirements (agreed in 2010) and OTC derivatives reforms – the analysis does not identify material negative effects on the provision and cost of infrastructure finance to date. The evaluation further finds:

- The overall amount of infrastructure finance has grown in recent years after a temporary drop during the financial crisis. Market-based finance – mainly project and particularly corporate bond issuance as well as non-bank financing – has accounted for most of the growth in advanced economies; but the analysis also points to some substitution in recent years of bank financing by market-based financing in advanced economies, and the G20 banking reforms may have been one of the drivers for this rebalancing.
- Lending spreads for infrastructure finance have returned to lower levels in recent years following a spike during the crisis, but remain above pre-crisis levels.
- There are some key differences in the provision of infrastructure finance in emerging market and developing economies (EMDEs) compared to advanced economies. EMDEs tend to rely more on bank loans, have a higher proportion of cross-border financing, and use local currency less for financing purposes.
- The reforms have contributed to shorter average maturities of infrastructure loans by G-SIBs – this effect is not necessarily unintended, given that reducing banks' maturity mismatch was one of the objectives of the reforms.
- While not analysing the *ex post* effects of reforms on financial resilience, the evaluation has found no results to suggest that the wider benefits to the financial system from enhanced resilience – as estimated at an aggregate level in *ex ante* impact assessment studies – do not apply in the narrower context of infrastructure finance.

On 23 November, the BCBS published *Implementation of Basel Standards*, a report to G20 Leaders on implementation of the Basel III regulatory reforms. This report summarises the steps taken by BCBS member jurisdictions to adopt the Basel III standards, banks' progress in bolstering their capital and liquidity positions, the consistency of implementation in jurisdictions assessed since the BCBS's last report and the BCBS's implementation work plan.

Alongside this, an FSI insight, *The Basel Framework in 100 Jurisdictions: Implementation Status and Proportionality Practices*, was published. In this paper, the authors explore the current state of implementation of key Basel standards and outline the associated proportionality practices, in 100 jurisdictions that are not members of the BCBS. They find that all jurisdictions have adopted some version of the Basel risk-based capital regime, while most have implemented, in some manner, quantitative liquidity standards and the large exposures rule.

In their implementation of Basel standards, nearly all jurisdictions apply proportionality, simplifying standards in some cases and applying more stringent requirements in others; and as countries shift to the Basel III risk-based capital regime, more extensive proportionality strategies are applied. This paper catalogues a range of proportionality practices applied in non-BCBS jurisdictions, providing a reference for authorities that seek to tailor the Basel framework to fit their country-specific circumstances.

With Mark Carney's term of office as FSB Chair ending on 1 December, it was announced, on 26 November, that the Plenary of the FSB has appointed Randal K. Quarles (Governor and Vice Chairman for Supervision at the US Federal Reserve) as its new Chair and Klaas Knot (President of De Nederlandsche Bank) as Vice Chair, each for a three-year term starting on 2 December. The Plenary also agreed that after three years, on 2 December 2021, Klaas Knot will take over as Chair for the next three-year term.

On 27 November, the FSB published a letter from its Chair to G20 Leaders, ahead of their Summit in Buenos Aires. The Chair highlights that 2018 has been a year of transition: (i) from robust, broad-based global growth to a more uneven global expansion with emerging downside risks; (ii) from accommodative to tightening financial conditions; and (iii) from strong capital inflows to emerging market economies to capital outflows from many of them, in some cases significantly so – and that these transitions are taking place against a backdrop of important structural changes in the financial system, with fast-growing sectors such as FinTech and non-bank finance bringing welcome diversity while also creating potential vulnerabilities.

The FSB has also transitioned. After a decade delivering the G20's ambitious reforms to address the fault lines that caused the global financial crisis, the FSB is pivoting to focus on implementing those reforms, evaluating their effectiveness, and adjusting them where necessary. In parallel, new policies are being developed to address new risks to financial stability. The letter reports on the FSB's delivery against its four priorities for this year:

1. *Addressing emerging vulnerabilities while harnessing the benefits of innovation:* the letter highlights the importance of continued vigilance to contain the risks of non-bank finance, including implementing the FSB's recommendations to address structural vulnerabilities associated with asset management; the publication of a cyber lexicon, and new work to develop effective practices for financial institutions' responses to, and recovery from, major cyber incidents. It also highlights the FSB's work to ensure that the G20 can harness the benefits of new financial technologies, while containing financial stability risks.
2. *Disciplined completion and implementation of the G20's reform priorities:* the FSB is working with standard-setters to complete work on a few final policy areas and focus on the implementation of the agreed financial reforms. Priorities include: (i) full, timely and consistent implementation of Basel III; (ii) finalising policy to deliver resilient, recoverable and resolvable CCPs; and (iii) work by the IAIS to deliver a new framework for addressing insurance sector systemic risks. The letter also highlights deliverables including completing a toolkit of measures to address the underlying causes of misconduct; and encouraging progress in mitigating the financial stability risks from climate change through the TCFD.
3. *Pivoting to policy evaluation to ensure reforms are delivering resilience efficiently:* the FSB's objectives are to assess whether reforms are operating as intended, and to identify and deliver adjustments where appropriate, without compromising on the agreed level of resilience. This dynamic implementation is to ensure that the G20 reforms remain fit for purpose amidst changing circumstances; and, to this end, the FSB delivered to the G20 Leaders' Summit the first two evaluations of reforms, on the effects on infrastructure finance and on incentives to CCP clear OTC derivatives.
4. *Optimising how the FSB works to maximise its effectiveness and*

*transparency:* the FSB's strength results from its multidisciplinary, consensus-based and member-driven approach. To make sure it is fit for the next phase, the FSB has reviewed how it works and will take a number of steps to improve process and transparency, including an enhanced approach to prioritisation of work focused on promoting financial stability and outreach with external stakeholders.

On 28 November, the FSB published its fourth annual report on the implementation and effects of the G20 financial regulatory reforms. The report documents the substantial progress that has been made in implementing key post-crisis financial reforms; discusses how the reforms have contributed to the core of the financial system becoming more resilient to economic and financial shocks; describes the FSB's work to evaluate whether reforms are working as intended; lays out why preserving financial stability, and supporting sustainable growth, requires the continued monitoring of developments in the global financial system; and documents the benefits of cooperation between jurisdictions in the aftermath of the crisis. The report, for the G20 Summit in Buenos Aires, calls for the support of G20 Leaders in implementing the agreed reforms, and reinforcing global regulatory cooperation.

On 29 November, the BCBS reported that at its meeting, on 26-27 November, the BCBS:

- agreed to a set of targeted revisions to the market risk framework, which would be submitted to the BCBS's governing body, the Group of Central Bank Governors and Heads of Supervision (GHOS) – if endorsed by the GHOS, the framework would be published in early 2019;
- agreed to consult on potential enhanced disclosures to reduce bank window-dressing behaviour related to the leverage ratio;
- approved a set of revisions to the Pillar 3 disclosure framework, for publication in December;
- reviewed a report setting out the range of bank, regulatory and supervisory cyber-resilience practices across jurisdictions, also for publication in December;
- discussed its ongoing evaluation of its post-crisis reforms, including the usability of capital buffers – leading to reaffirmation of the usefulness of buffers as a loss-absorbing mechanism;
- took note of the comments received on its discussion paper on the regulatory treatment of sovereign exposures;
- discussed its work programme and strategic priorities for 2019, with the expectation that the work programme will be published in early 2019, following review and endorsement by GHOS; and
- agreed to consult, in 2019, on a framework which would consolidate the BCBS's standards into a single integrated framework.

The BCBS also reported that the 20th International Conference of Banking Supervisors (ICBS), which was hosted by the Central Bank of the UAE, took place on 28-29 November. Delegates discussed the evolution of the regulatory landscape over the past decade and the implications for regulation and supervision.

Discussions at the ICBS included best practices for evaluating the impact of post-crisis reforms, the role of proportionality in the Basel framework, and the importance of implementing the post-crisis reforms in a full, timely and consistent manner. Looking forward, participants exchanged views on the supervisory challenges following the completion of Basel III, the implications of financial technology for banks and supervisors, and the importance of strengthening operational resilience, including cyber-resilience.

Ten years after the first G20 Leaders' Summit, their latest gathering in Buenos Aires, on 30 November-1 December, resulted in a declaration of their agreed intent to build consensus for fair and sustainable development through an agenda that is people-centred, inclusive and forward-looking. Within this declaration, the most pertinent paragraph with respect to the continuing process of financial regulatory reform is number 25, which states:

- "An open and resilient financial system, grounded in agreed international standards, is crucial to support sustainable growth.
- We remain committed to the full, timely and consistent implementation and finalization of the agreed financial reform agenda, and the evaluation of its effects.

**An open and resilient financial system, grounded in agreed international standards, is crucial to support sustainable growth.**

- We will continue to monitor and, if necessary, tackle emerging risks and vulnerabilities in the financial system; and, through continued regulatory and supervisory cooperation, address fragmentation.
- We look forward to continued progress on achieving resilient non-bank financial intermediation.
- We will step up efforts to ensure that the potential benefits of technology in the financial sector can be realized while risks are mitigated.
- We will regulate crypto-assets for anti-money laundering and countering the financing of terrorism in line with FATF standards and we will consider other responses as needed.
- We thank Mr. Mark Carney for his service as FSB Chair and we welcome the appointment of Mr. Randal K Quarles, as Chair of the FSB and of Mr. Klaas Knot, as Vice Chair."

Considering other aspects of finance and markets, the following paragraphs of the declaration are also significant:

"24. We will continue to monitor cross-border capital flows and deepen our understanding of the available tools, so we can harness their benefits while also managing the risks and enhancing resilience. We will continue to take steps to address debt vulnerabilities in low income countries by supporting capacity building in public debt and financial management, and strengthening domestic policy frameworks. We will work towards enhancing debt transparency and sustainability, and improving sustainable financing practices by borrowers and creditors, both official and private, including infrastructure financing. We support ongoing work by the IMF, WBG and Paris Club on low income countries debt and the continued efforts of the Paris Club towards the broader inclusion of emerging creditors. We welcome the final report of the G20 Eminent Persons Group on Global Financial Governance."

"10. Infrastructure is a key driver of economic prosperity, sustainable development and inclusive growth. To address the persistent infrastructure financing gap, we reaffirm our commitment to attract more private capital to infrastructure investment. To achieve this, we endorse the Roadmap to Infrastructure as an Asset Class and the G20 Principles for the Infrastructure Project Preparation Phase. We are taking actions to achieve greater contractual standardization, address data gaps and improve risk mitigation instruments. In line with the Roadmap, we look forward to progress in 2019 on quality infrastructure."

"13. Mobilizing sustainable finance and strengthening financial inclusion are important for global growth. We welcome the Sustainable Finance Synthesis Report 2018, which presents voluntary options to support deployment of sustainable private capital. We endorse the G20 Financial Inclusion Policy Guide, which provides voluntary policy recommendations to facilitate digital financial services, taking into account country contexts and the Global Partnership for Financial Inclusion Roadmap which outlines a process to streamline its work program and structure."

Following Argentina, Japan has now assumed the G20 Presidency and plans the next Leaders' Summit in Osaka, on 28-29 June. Ahead of this, the G20 finance track schedule for 2019 includes meetings of Finance and Central Bank Deputies, in Tokyo, on 17-18 January; in Washington, D.C., on 11 April; and in Fukuoka, on 6-7 June; together with meetings of Finance Ministers and Central Bank Governors, in Washington, D.C., on 11-12 April; and in Fukuoka, on 8-9 June. Priorities for the G20 finance track in 2019 are identified under three headings: (i) global economy – risks and challenges; (ii) actions toward robust growth; and (iii) response to structural changes caused by innovation and globalization – including addressing financial market fragmentation.

On 11 December, the BCBS published updated Pillar 3 disclosure requirements which, together with the updates published in January 2015 and March 2017, complete the Pillar 3 framework – that seeks to promote market discipline through regulatory disclosure requirements. The revised framework reflects the BCBS's December 2017 Basel III post-crisis regulatory reforms and pertains to the following areas: (a) credit risk, operational risk, the leverage ratio and credit valuation adjustment (CVA) risk; (b) RWAs as calculated by the bank's internal models and according to the standardised approaches; and (c) an overview of risk management, RWAs and key prudential metrics.

In addition, the updated framework sets out new disclosure requirements on asset encumbrance and, when required by national supervisors at the jurisdictional level, on capital distribution constraints. The implementation deadline for the disclosure requirements related to Basel III is 1 January 2022 – in line with the implementation of the Pillar 1 framework. The deadline for the disclosure requirements for asset encumbrance, capital distribution constraints and the prudential treatment of problem assets has been extended by one year to end-2020.

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# Adopting international practices for bond trustee arrangements in China

## By Ricco Zhang

China's National Association of Financial Market Institutional Investors (NAFMII) and ICMA have published a guide which sets out international bond trustee arrangements and their application worldwide, along with the global practices of bond trustee services. *International Practices of Bond Trustee Arrangements* serves to highlight how a bond trustee structure, adapted to the needs of the Chinese market, may have a role to play in creating safeguards for bond investors and in reducing overall capital market and systemic risk.

This report, by the joint NAFMII-ICMA Working Group established in 2015 and produced under the auspices of the 9th UK-China Economic and Financial Dialogue, includes the input of several trustees who have first-hand experience in developed bond markets illustrating international market practices, summarising the role of the bond trustee both before and after a default, and clarifying the duties of each interested party after an event of default.

In particular, the report presents a detailed look at the trustee system in developed bond markets, covering its origin, history, institutional value, and state of global adoption. It also provides a systematic overview on such aspects as legal basis, applicability, qualification requirements, duties and rights, and conflicts of interest and solution, and an overview of their practical significance.

As China's bond markets continue to develop, they are playing a growing role in supporting the real economy and meeting the varied investment, financing and risk management needs of market participants. The onshore Chinese financial system is increasingly adopting market-oriented mechanisms, improving supporting infrastructures, and offering more diversified products. As these changes bring about new and increased capital market risks, policy makers have renewed focus on reviewing the mechanisms in China currently in place to safeguard investors.

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## European financial regulatory reforms

On 3 October 2018, ESMA published its *2019 Work Programme*, which sets out its priorities and areas of focus for 2019 in support of ESMA's mission to enhance investor protection and promote stable and orderly financial markets. ESMA, in line with its Strategic Orientation 2016-2020, will maintain its focus on its activities of supervisory convergence and assessing risks in financial markets. Additionally, ESMA will take on new direct supervisory responsibilities under the SFTR and the Securitisation Regulation. It will also support the Sustainable Finance Initiative through a set of priority actions, aiming to integrate ESG considerations as part of the investment chain. Preparations for Brexit will continue to be a major focus for ESMA in 2019, which will require ESMA to be prepared to adapt and reprioritise the WP as needed. Further adaptation of ESMA's work programme in 2019 could be required to take account of the potential revisions of ESMA's mandate under the ESAs' Review and EMIR 2.2.

In 2019 the key areas of focus under ESMA's activities of supervisory convergence, assessing risks, single rulebook and direct supervision will be:

- supporting the consistent application of MiFID II and MiFIR along with the Prospectus Regulation and Securitisation Regulation by market participants and NCAs;
- utilising the data gathered under MiFID II/MiFIR to support its work on stable and orderly markets;
- contributing to the implementation of the CMU Action Plan and of the FinTech Action Plan; and
- enhancing the effectiveness of its supervisory activities for CRAs and TRs, while preparing for the registration and supervision of new entities under the Securitisation Regulation and SFTR.

EIOPA's Single Programming Document 2019-2021 with *Annual Work Programme 2019* is dated 27 September. Throughout this 2019-2021 period, EIOPA's overarching mission remains the protection of policyholders and beneficiaries and financial stability. To achieve this, EIOPA will continue to work to deliver high-quality regulation, technical advice and analysis at European level, and support to national competent authorities (NCAs) to strengthen supervision in Europe. In the coming years, EIOPA's key priority is to further enhance supervisory convergence with the aim of moving towards a common supervisory culture. As part of its supervisory convergence agenda, EIOPA will focus on building common standards and interpretations, on leveraging data for risk assessment and supervisory purposes, on monitoring common standards and on challenging and supporting NCAs. In light of their growing importance, the Authority has added "InsurTech" and sustainable finance to its ongoing priorities.

On 9 October, the Joint Committee of the ESAs published its *2019 Work Programme*. In 2019, under the chairmanship of EIOPA, the three ESAs will continue their work in the areas of consumer protection, cross-sectoral risk analysis, AML/CFT, and financial conglomerates, as well as accounting and auditing. The Joint Committee will particularly focus its work on PRIIPs, financial innovation, sustainable finance and securitisation, as well as on improving the cooperation of AML/CFT supervisors and the consistent application of AML/CFT standards in the EU.

On 23 October, EBA published its detailed annual work programme for 2019, describing the specific activities and tasks of the Authority for the coming year and highlighting the key strategic areas of work from 2019 to 2021. In 2019, EBA will focus on: (i) leading the Basel III implementation in the EU; (ii) understanding risks and opportunities arising from financial innovation; (iii) collecting, disseminating and analysing banking data; (iv) ensuring a smooth relocation of the EBA to Paris; and (v) fostering the increase of the loss-absorbing capacity of the EU banking system.

> **A fully functioning Capital Markets Union with deep and liquid markets is crucial for financial stability, to support the Single Market, and to diversify sources of finance.**

Also on 23 October, the European Commission presented its *Work Programme for 2019*, setting out three main priorities for the year ahead: reaching swift agreement on the legislative proposals already presented to deliver on its ten political priorities; adopting a limited number of new initiatives to address outstanding challenges; and presenting several initiatives with a future perspective for a Union at 27 reinforcing the foundations for a strong, united and sovereign Europe. The 2019 Work Programme focuses on just 15 new initiatives, and an additional 10 new REFIT evaluations, to review existing legislation and ensure it is still fit for purpose. To ensure a focus on delivery, the Commission Work Programme also lists the 45 pending priority proposals under the Joint Declaration on legislative priorities, for adoption by the Parliament and Council before the European elections. The Commission also suggests withdrawing or repealing 17 pending proposals or existing laws.

Specifically considering ongoing work relating to financial markets, the *Work Programme* includes the follow pertinent extracts:

- "In June 2018, at the Euro Summit in which all Member States participated, Leaders agreed to complete the Banking Union, including through creating a common backstop to the Single Resolution Fund and progress towards the European Deposit Insurance Scheme. They also agreed on strengthening the role and developing further the European Stability Mechanism as a crisis management tool. This work needs to be taken forward as a priority, whilst swift agreement is now required in particular on the proposals on risk reduction in the banking sector as well as the package on the reduction of non-performing loans."
- "A fully functioning Capital Markets Union with deep and liquid markets is crucial for financial stability, to support the Single Market, and to diversify sources of finance for European business, including for smaller companies. It is high time to find agreement on the proposals on the pan-European Personal Pension Product, the European Market Infrastructure reform, the improvement of the EU's financial supervisory architecture and the proposal on business insolvency, restructuring and second chance. Agreement should also be reached on other Capital Markets Union proposals on crowdfunding, covered bonds, facilitating cross-border distribution of investment funds,

promoting SME listing on public markets, and more proportionate and effective rules for investment firms. In light of the recent serious revelations of money laundering in the financial sector, it is also vital to reach swift agreement on the proposals to establish stronger anti-money laundering supervision to ensure that rules are better supervised and enforced across the EU."

- "We also need agreement on the Commission proposals ... on sustainable finance to mobilise the private capital necessary to support the EU's climate and sustainable development agenda."
- "To complete the work to deliver an effective Security Union it is now crucial to agree on the proposals ... on facilitating cross-border access to and use of financial data by law enforcement authorities."

Looking ahead, in the context of the future of Europe, the *Work Programme* also states that the Leader's Summit in Sibiu, Romania, on 9 May 2019, "will take place at a pivotal moment – six weeks after Brexit and two weeks before the European Parliament elections. This will be the moment when Leaders provide renewed confidence in the future of the new Union of 27. The Commission will contribute to the process leading up to and beyond Sibiu with a number of reports and communications with a 2025 perspective. It has presented, or will put forward, initiatives aiming to", among others:

- strengthen the international role of the euro, as part of global efforts to strengthen Europe's sovereignty;
- enhance the use of qualified majority voting and allow more efficient decision-making in key fields of taxation and social policies, so that the EU Single Market legislation can keep pace with economic and societal developments, as well as in several targeted areas of our external relations to offer the right decision-making tools for our Common Foreign and Security Policy; and
- reflect on the road towards a Sustainable Europe by 2030 to follow up on the UN Sustainable Development Goals, including the Paris agreement on Climate Change.

**The Commission also calls for renewed political engagement and efforts to complete key building blocks of the CMU.**

On 7 November, ESMA published an overview of the compliance status declared by national competent authorities (NCAs) as regards the application of ESMA guidelines in their respective jurisdictions. This *Compliance with Guidelines – Overview Table* is a compilation of individual guidelines compliance tables, already available on ESMA's website. The ESMA Regulation requires NCAs to inform ESMA whether they comply, intend to comply or do not comply with guidelines issued by ESMA; and in case an NCA does not comply or does not intend to comply, it must inform ESMA about its reasons – the reasons for non-compliance as well as any other relevant information provided by NCAs are directly accessible in the overview table.

On 28 November, ahead of the December European Council and Euro Summit where decisions on deepening EMU were due to be taken, the European Commission reported on progress in risk reduction in the Banking Union and called for faster progress on CMU. In its third progress report on the reduction of NPLs the Commission highlighted that, while efforts need to continue to address legacy issues still weighing on the European banking sector since the financial crisis, NPLs in the sector have declined further, now standing at an EU average of 3.4%. In a separate Communication, the Commission also calls for renewed political engagement and efforts to complete key building blocks of the CMU, ahead of the European elections next May. Together with the completion of the Banking Union, this is considered essential for the development of EMU and strengthening the international role of the euro.

On 4 December, the European Council announced its endorsement of the agreement achieved between the Austrian Presidency and the European Parliament on key measures of a comprehensive legislative package aimed at reducing risks in the EU banking sector. While intended to implement reforms agreed at international level, the agreed measures also deliver on three of the key objectives set out by the Council roadmap on completing the banking union agreed in June 2016:

- enhancing the framework for bank resolution, in particular the necessary level and quality of the subordination of liabilities (MREL) to ensure an effective and orderly "bail-in" process;

- introducing the possibility for resolution authorities to suspend a bank's payments and/or contractual obligations when it is under resolution – the so-called "moratorium tool" –, so as to help stabilise the bank's situation; and
- strengthening bank capital requirements to reduce incentives for excessive risk taking, by including a binding leverage ratio, a binding NSFR and setting risk sensitive rules for trading in securities and derivatives.

The package also contains a framework for the cooperation and information sharing among the various authorities involved in the supervision and resolution of cross-border banking groups; and introduces amendments to improve cooperation between competent authorities on matters related to the supervision of AML activities. Work on remaining outstanding issues will continue both at technical and political level, in view of finalising negotiations on the package by the end of the year, with the Parliament and Council then to be called upon to adopt the proposed regulation at first reading.

On 14 December, it was announced that the Euro Summit had endorsed all the elements of the Eurogroup report to Leaders on EMU deepening. In particular, the Euro Summit:

- Endorsed the terms of reference of the common backstop to the SRF, which set out how the backstop will be operationalised.
- Endorsed the term sheet on ESM reform, and asked the Eurogroup, on that basis, to prepare the necessary amendments to the ESM Treaty (including the common backstop to the SRF) by June 2019.
- Looked forward to the final adoption of the Banking Package and the NPL Prudential Backstop preserving the balance of the Council compromises, and called to advance work on the Banking Union and for ambitious progress by spring 2019 on the CMU, as outlined in the Eurogroup report.
- In the context of the Multiannual Financial Framework, mandated the Eurogroup to work on the design, modalities of implementation and timing of a budgetary instrument for convergence and competitiveness for the euro area, and ERM II Member States on a voluntary basis. The features of the budgetary instrument will be agreed in June 2019 and the instrument will be adopted in accordance with the legislative procedure on the basis of the relevant Commission proposal, to be amended if necessary.
- Took note of the communication of the Commission on a stronger international role of the euro and encouraged work to be taken forward to this end.

Romania holds the Presidency of the Council of the EU, for the first time since it joined the EU, from January to June 2019. This opens the Trio of Presidencies composed also of Finland and Croatia, and it will be the final Presidency acting during the current legislative cycle of the European Parliament. Under the motto of cohesion, the Romanian Presidency will focus on four main priorities: Europe of convergence; a safer Europe; Europe as a stronger global actor; and Europe of common values. Digital transformation will also be a highlight of Romania's Presidency, with cybersecurity, innovation and skills, women in tech, and AI being just some of Romania's digital priorities.

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## Macroprudential risk

On 4 October 2018, the ESRB reported on the 31st regular meeting of its General Board, held on 27 September. In this meeting, the General Board noted that risks to the stability of the EU financial system remain elevated amid significant political uncertainties globally and within the EU. The General Board exchanged views on vulnerabilities related to financial and banking markets, focusing on the potential for further market repricing and the implications for the EU financial system, also in relation to the relevant macroprudential policy measures already activated. Furthermore, the General Board discussed technical aspects of the ongoing monitoring of developments in the EU derivatives markets and considered the need to establish a broader macroprudential toolkit for insurance.

> **Although most countries have deleveraged somewhat in recent years, debt levels remain elevated across countries and sectors in the EU.**

Alongside this report, the ESRB released the 25th issue of its *Risk Dashboard*. This records that risks to financial stability in the EU remain a concern, as reflected by market-based indicators of systemic stress in the EU over the past quarter. Considering macro risk, although most countries have deleveraged somewhat in recent years, debt levels remain elevated across countries and sectors in the EU. Regarding credit risk, the cost of borrowing for the private sector remains low, reflecting the low interest rate environment, and credit standards continued to ease over the last quarter. Concerning sectors, the resilience of banks continued to strengthen in the second quarter of 2018; solvency and profitability indicators suggest that EU insurance is performing well; total assets of EU investment funds and other financial institutions changed little in 2017; and in recent quarters CCPs' collateral has remained broadly stable.

On 4 October, the BCBS published the results of its latest Basel III monitoring exercise based on data as of 31 December 2017. For the first time, the report sets out the impact of the Basel III framework that was initially agreed in 2010 as well as the effects of the BCBS's December 2017 finalisation of the Basel III reforms. Data have been provided for a total of 206 banks, including 111 large internationally active (Group 1) banks – among which are all 30 of the G-SIBs. The final Basel III minimum requirements are expected to be implemented by 1 January 2022 and fully phased in by 1 January 2027. On a fully phased-in basis, the capital shortfalls at the end-2017 reporting date are €25.8 billion for Group 1 banks at the target level.

The monitoring reports also collect bank data on Basel III's liquidity requirements. Basel III's LCR was set at 60% in 2015, rising stepwise to reach 100% in 2019. The weighted average LCR for the Group 1 bank sample was 133% on 31 December 2017, with all reporting an LCR at or above the 90% minimum requirement that will be in place for 2018; and their weighted average NSFR was 116%. For the other, Group 2, banks the weighted average LCR was 180%, with all reporting an LCR that met or exceeded 100%; and their weighted average NSFR was 118%. As of December 2017, 97% of the Group 1 banks (including all G-SIBs) and 95% of the Group 2 banks in the NSFR sample reported a ratio that met or exceeded 100%, while all banks reported an NSFR at or above 90%.

Also on 4 October, the EBA published two reports, which measure the impact of implementing Basel III reforms and monitor the current implementation of liquidity measures in the EU. The EBA Basel III capital monitoring report includes a preliminary assessment of the impact of the Basel reform package on EU banks assuming its full implementation – with the EBA estimating that this would mean an average increase by 16.7% of EU banks' Tier 1 minimum required capital. The report on liquidity measures monitors and evaluates the liquidity coverage requirements currently in place in the EU. The LCR of EU banks stood at around 145% in December 2017, materially above the minimum threshold of 100%. More in-depth analysis of potential currency mismatches in LCR levels, suggests that banks tend to hold lower liquidity buffers in some foreign currencies, in particular US$.

Published on 4 October, *Systemic Liquidity Concept, Measurement and Macroprudential Instruments* is an occasional paper, prepared by the ECB Task Force on Systemic Liquidity. This study provides a conceptual and monitoring framework for systemic liquidity, complementing previous work on liquidity and focusing on the development of liquidity risk at the system-wide level. A dashboard with a total of 20 indicators is developed for the financial system, including banks and non-banks, to assess the build-up of systemic liquidity risk over time. In addition, this study sheds light on the legal basis for additional macroprudential liquidity tools under existing EU laws, which is a key condition for the implementation of macroprudential liquidity tools.

On 8 October, the EBA published the latest update to its *Risk Dashboard*, which summarises the main risks and vulnerabilities in the EU banking sector using quantitative risk indicators. In Q2 2018, the updated Dashboard identified ongoing improvements in the repair of the EU banking sector but also residual risks in banks' profitability. European Banks' capital ratios remained high, in line with Q1 2018 – the CET1 ratio remained at 14.5%, with a slight increase in the value of CET1 capital, accompanied by an increase in total risk exposures. EU banks continued to improve overall quality of their loans' portfolio and the loan to deposit ratio reached its lowest value since 2014, mainly due to an increase in deposits.

Published on 15 October, *Beyond Spreads: Measuring Sovereign Market Stress in the Euro Area* is an ECB staff working paper. The authors propose a composite indicator that measures multi-dimensional sovereign bond market stress in the euro area as a whole and in individual euro area member states. It integrates measures of credit risk, volatility and liquidity at short-term and long-term bond maturities into a broad measure of sovereign market stress – the Composite Indicator of Systemic Sovereign Stress (SovCISS). The authors implement the SovCISS for 11 euro area Member States and also present four options of a SovCISS for the entire monetary union. In addition, they suggest a linear decomposition of the SovCISS. Finally, an application of the country-specific SovCISS indicators to the VAR-based spillover literature suggests that stress mainly originates from a few euro area countries, and that spillover patterns vary over time.

On 17 October, the BCBS issued the final version of its *Stress Testing Principles*, which focus on the core elements of stress testing frameworks. This replaces the BCBS's 2009 *Principles for Sound Stress Testing Practices and Supervision*, which addressed key weaknesses in stress testing practices as highlighted by the global financial crisis. Since then, the role of stress testing has grown in importance. It is now both a critical element of risk management for banks and a core tool for banking supervisors and macroprudential authorities. The updated principles reflect this evolution; and have been streamlined and set at a high level so that they can be applied across banks and jurisdictions while remaining relevant as stress testing practices continue to evolve.

On 22 October, EIOPA published its updated *Risk Dashboard* based on the second quarter 2018 data, showing that the risk exposure of the EU insurance sector remains stable overall. Macro risks continue at medium level amid continued economic recovery and less expansionary monetary policy. Bond market volatility declined since June and overall CDS spreads remained broadly stable at low levels despite adverse developments in sovereign bond markets in some countries. Liquidity and funding risks increased due to a higher average coupon-to-maturity ratio of a limited number of bond issuances. Profitability has been overall stable and solvency capital requirement ratios are above 100% for most insurers.

On 2 November, the EBA published the results of the 2018 EU-wide stress test, which involved 48 banks from 15 EU and EEA countries, covering broadly 70% of total EU banking sector assets. The adverse scenario has an impact of -395 bps on banks' CET1 fully loaded capital ratio (-410 bps on a transitional basis), leading to a 10.1% CET1 capital ratio at the end of 2020 (10.3% on a transitional basis). The objective of the exercise is to assess, in a consistent way, the resilience of banks to a common set of adverse shocks. The 2018 EU-wide stress test does not contain a defined pass/fail threshold. However, the results are used as an input to the supervisory decision-making process and to promote market discipline.

Published on 2 November, *Monetary and Macroprudential Policy Coordination Among Multiple Equilibria* is an IMF staff working paper. The notion of a trade-off between output and financial stabilization is based on monetary-macroprudential models with unique equilibria. Using a game theory set-up, this paper shows that multiple equilibria lead to qualitatively different results. Monetary and macroprudential authorities have tools that impose externalities on each other's objectives. One of the tools (macroprudential) is coarse, while the other (monetary policy) is unconstrained. The author finds that this asymmetry always leads to multiple equilibria and shows that under economically relevant conditions the authorities prefer different equilibria. Giving the unconstrained authority a weight on "helping" the constrained authority ("leaning against the wind") now has unexpected effects, with a small degree of leaning worsening both authorities' outcomes.

Published on 9 November, *The Leverage Ratio, Risk-Taking and Bank Stability* is a Bank of England staff working paper. It addresses the trade-off between additional loss-absorbing capacity and potentially higher bank risk-taking associated with the introduction of the Basel III leverage ratio. Using a theoretical micro model, the authors show that a leverage ratio requirement can incentivise banks that are bound by it to increase their risk-taking; but this increase in risk-taking should be more than outweighed by the benefits of higher capital, thereby leading to more stable banks. These theoretical predictions are tested and confirmed in an empirical analysis on a large sample of EU banks. The authors' baseline empirical model suggests that a leverage ratio requirement would lead to a significant decline in the distress probability of highly leveraged banks.

On 14 November, IOSCO requested feedback, by 1 February, on a proposed framework to help measure leverage used by investment funds, which in some circumstances could pose financial stability risks. The proposed framework comprises a two-step process which seeks an appropriate balance between achieving precise leverage measures and devising simple, robust metrics that can be applied in a consistent manner to a wide range of funds in different jurisdictions. It also addresses synthetic leverage, by including exposure created by derivatives; considers different approaches to analysing netting and hedging and the directionality of positions; and includes approaches that limit model risk.

The first process step, which this consultation is mainly focused on, indicates how regulators could exclude from consideration funds that are unlikely to create stability risks to the financial system while filtering and selecting a subset of other funds for further analysis. The second step calls for regulators to conduct a risk-based analysis of the remaining subset of investment funds. IOSCO does not prescribe a particular set of metrics or other analytical tools – instead, each jurisdiction is expected to determine which is the most appropriate risk assessment for it to adopt, given that some risk-based measures are not appropriate for all funds.

Published on 15 November, *Systemic Illiquidity in the Interbank Network* is an ESRB working paper. The authors study systemic illiquidity using a unique dataset on banks' daily cash flows, short-term interbank funding and liquid asset buffers. Failure to roll over short-term funding or repay obligations when they fall due generates an externality in the form of systemic illiquidity. The authors simulate a model in which systemic illiquidity propagates in the interbank funding network over multiple days. In this setting, systemic illiquidity is minimised by a macroprudential policy that skews the distribution of liquid assets towards banks that are important in the network.

On 26 November, the ESRB published a report on macroprudential provisions, measures and instruments for (re)insurance. Given the importance of the (re)insurance sector, the report serves as an input to ongoing Solvency II discussions on strengthening the regulatory framework for (re)insurers from a macroprudential perspective; and complements work undertaken by EIOPA. The ESRB has identified options that could further strengthen the macroprudential framework for (re)insurance and target systemic risks. Further work on these options should take into account international developments and changes in current regulation and determine the appropriate level of legislation.

**There is a possibility of broader stress in emerging markets, with rising debt sustainability concerns and trade tensions posing challenges.**

On 28 November, the Bank of England published its latest Financial Stability Report, along with *Systemic Risk Survey Results* for H2 2018; analysis of EU withdrawal scenarios and monetary and financial stability; and the results of the 2018 stress testing of the UK banking system – which show that UK banks could continue to lend in a scenario more severe than the financial crisis. The Financial Policy Committee (FPC) has reviewed a disorderly Brexit scenario, with no deal and no transition period, that leads to a severe economic shock. Based on a comparison of this scenario with the stress test, the FPC judges that the UK banking system is strong enough to continue to serve UK households and businesses even in the event of a disorderly Brexit – with major UK banks having sufficient liquidity to withstand a major market disruption.

Most risks of disruption to the financial services that EU firms provide to UK households and businesses have been addressed, including through legislation; but further UK legislation, currently in train, will need to be passed to ensure the legal framework for financial services is fully in place ahead of Brexit.

Additionally, (i) the FPC maintained the UK CCyB rate at 1% and stands ready to move this rate in either direction as the risk environment evolves; (ii) leveraged lending to businesses has grown rapidly, both globally and, more recently, in the UK; and (iii) risks to UK financial stability from global debt vulnerabilities are material. Also, the FPC has completed an in-depth assessment of the risks associated with leverage from the use of derivatives in the non-bank financial system, finding that risks of forced sales to meet derivative margin calls currently appear limited but that more comprehensive and consistent monitoring by authorities is needed.

Subsequently, on 29 November, the ECB published its latest euro area Financial Stability Review, reporting that the environment has become more challenging since May. There is a possibility of broader stress in emerging markets, with rising debt sustainability concerns and trade tensions posing challenges; and while bank resilience has improved, structural vulnerabilities continue to restrain profitability.

Also, liquidity concerns are growing amid increased risk-taking outside the banking sector – notably in the investment fund sector. Over the past ten years the total assets of euro area investment funds have more than doubled to €13.8 trillion in June 2018, with the size of the non-bank financial sector approaching half that of the euro area banking sector. Growing exposures to illiquid and risky assets make the funds vulnerable to potential shocks in global financial markets.

This review also contains three special features: (i) an examination of how banks can reach sustainable levels of profitability; (ii) an examination of the implications for financial stability of a resurgence of trade tariffs; and (iii) a discussion of the rapid growth in ETFs and their potential for transmitting and amplifying risks within the financial system.

On 29 November, ESMA issued the latest iteration of its *Risk Dashboard*, covering risks in the EU's securities markets for Q3 2018. ESMA's overall risk assessment remains unchanged from Q2 2018 at high levels. Equity markets increased slightly over the course of the Q3 2018, however market nervousness and sensitivity are rising, as evidenced by the global equity market sell-off at the beginning of October. The budget plans of Italy have led to sovereign bond market volatility remaining at a high level, and generally high market valuations coupled with market uncertainty contribute to very high market risk. Going forward, ESMA sees concerns over a potential no-deal Brexit increasingly weighing on economic and market expectations. Risks to business operations from Brexit as well as from cyber threats continue to be a major concern, leading operational risk to remain elevated with a negative outlook.

Published on 7 December, *Macroprudential Capital Regulation in General Equilibrium* is a Bank of England staff working paper. The authors examine macroprudential bank capital policy in a macroeconomic model with a financial accelerator originating in the banking sector. Under Ramsey-optimal policy, the bank capital buffer tracks closely a model-based measure of the credit gap (the gap between equilibrium credit in the economy featuring financial frictions and that in a hypothetical frictionless one). Simple rules that vary the capital buffer in response to the credit gap perform worse than Ramsey policy, but only modestly so. When monetary policy controls inflation less aggressively, optimal macroprudential responses are smaller. Optimal macroprudential policy operates at a lower frequency than monetary policy.

Also published on 7 December, *The Micro Impact of Macroprudential Policies: Firm-Level Evidence* is an IMF staff working paper. Combining balance sheet data on 900,000 firms from 48 countries with information on the adoption of macroprudential policies during 2003-2011, the authors find that these policies are associated with lower credit growth. These effects are especially significant for micro, small and medium enterprises (MSMEs) and young firms that, according to the literature, are more financially constrained and bank dependent. Among MSMEs and young firms, those with weaker balance sheets exhibit lower credit growth in conjunction with the adoption of macroprudential policies, suggesting that these policies can enhance financial stability. Finally, the results show that macroprudential policies have real effects, as they are associated with lower investment and sales growth.

On 13 December, the ESRB reported on the 32nd regular meeting of its General Board, held on 6 December. In this meeting, the General Board noted that risks to the stability of the EU financial system remain elevated amid significant political uncertainties globally and within the EU. Against this background, the General Board exchanged views on the potential vulnerabilities related to cyclical developments. The General Board also discussed financial stability risks that could stem from cyber incidents; continued to advance on the monitoring of developments in the EU derivatives markets; considered the role that macroprudential policy can play in preventing system-wide increases in NPLs and/or in increasing banks' resilience to such an increase; and exchanged views on the interoperability arrangements of CCPs.

Additionally, the General Board held a discussion on the key concepts framing macroprudential stance – the work done so far will be translated into a first ESRB report, which will be published in the coming months, providing an initial step towards a common framework for macroprudential stance and outlining one conceptual approach to it.

Alongside this report, the ESRB released the 26th issue of its *Risk Dashboard*. This records that risks to EU financial stability remained a concern as reflected by the market-based indicators of systemic stress in the EU over the past quarter. Considering macro risk, debt levels remain elevated across countries and sectors in the EU, although most countries deleveraged somewhat in the recent years.

On 14 December, the EBA published its annual report on risks and vulnerabilities in the EU banking sector, accompanied by the results of the EBA's 2018 EU-wide transparency exercise, which provides detailed information, in a comparable and accessible format, for 130 banks across the EU. Overall, the EU banking sector has continued to benefit from the positive macroeconomic developments in most European countries, which contributed to the increase in lending, further strengthening of banks' capital ratios and improvements in asset quality. Profitability remains low on average and has not yet reached sustainable levels. Despite increasing stable customer

**Replacing financing from central banks will be a key driver for banks' funding plans, which will also be driven by MREL issuance needs.**

deposit funding, banks are facing key challenges on the liability side. Replacing financing from central banks will be a key driver for banks' funding plans, which will also be driven by MREL issuance needs.

Also on 14 December, EIOPA published the results of its 2018 and fourth stress test for the European insurance sector. This year's exercise assessed the participating insurers' resilience to three severe but plausible scenarios. 42 European (re)insurance groups participated, representing a market coverage of around 75 % based on total consolidate assets, and the reference date was 31 December 2017. The impact of the different scenarios on the balance sheet position and on the capital position of the participating groups was assessed by the excess of assets over liabilities and an estimation of the post-stress solvency capital requirement ratio. Overall, the exercise confirmed the significant sensitivity to market shocks combined with specific shocks relevant for the European insurance sector, nevertheless, on aggregate, the sector is adequately capitalised to absorb the prescribed shocks.

Published on 14 December, *Domestic and External Sectoral Portfolios: Network Structure and Balance-Sheet Contagion* is an ECB staff working paper. The authors use a unique, comprehensive database on French security assets and liabilities to study the dynamics of domestic and external sectoral portfolios, their network structure, and their role in the propagation of shocks. They first show how the sharp deterioration of the net external portfolio position of France between 2008 and 2014 was driven by sectoral patterns, such as the banking sector retrenchment and the increase in foreign liabilities of the public and corporate sectors, but was mitigated by the expansion of domestic and foreign asset portfolios of insurance companies. Second, they put forward and estimate a model of balance-sheet contagion through inter-sectoral security linkages. The estimation of the model shows that the financial sectors of the economy are affected by balance-sheet contagion.

On 16 December, the latest BIS Quarterly Review was published. This reports that financial markets went through a further sharp correction during the last quarter, marking another bump in the road as major central banks return policy to more normal settings. Among other things this issue of the review examines how the recent default of a single trader resulted in an extraordinary loss of more than €100 million for a Swedish CCP and its members – demonstrating the importance of preparation and a long-term perspective in risk management. It also includes a special feature which studies the close interactions between SIBs and CCPs in OTC derivatives markets, which have become more concentrated as CCP clearing has increased. While CCP clearing has strengthened the financial system overall, these interactions can potentially amplify stresses in some scenarios – reinforcing the need to think about risks in banks and CCPs jointly rather than in isolation..

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## Interest rate benchmarks

RFR

This issue of the ICMA Quarterly Report includes a Quarterly Assessment and two feature articles relating to work on interest rate benchmarks and the transition from IBORs, including details of several relevant recent developments.

On 30 October, the US Alternative Reference Rates Committee (ARRC) released additional information regarding its support of the transition from US dollar LIBOR. To do so, the ARRC provided a timeline of key milestones to serve as a guide for those interested in following the progress to date, which includes implementing the ARRC's Paced Transition Plan.

On 14 November, the FSB published its latest progress report on implementation of its recommendations to reform major interest rate benchmarks and will publish a further progress report in late 2019. This report sets out the progress made on the development of overnight near risk-free rates (RFRs), and markets based on these rates, and on further reforms to interbank offered rates (IBORs). The FSB has recently intensified its monitoring and coordination efforts given the importance of effective implementation of the reforms. The progress report considers three key areas:

1. *IBORs:* although LIBOR has been strengthened, authorities have warned that publication of LIBOR may cease once official sector support for the benchmark is withdrawn at end-2021. Work has continued among the other major IBORs (EURIBOR and TIBOR) to strengthen existing methodologies to make them more grounded in actual transactions, as well as to strengthen regulatory frameworks and supervision. In other jurisdictions, actions are also underway to implement further regulatory reforms.

**The FSB has recently intensified its monitoring and coordination efforts given the importance of effective implementation of the reforms.**

2. *Alternative reference rates:* in the markets which face the disappearance of IBORs, notably markets currently reliant on LIBOR, there needs to be an orderly transition to new reference rates that are sufficiently robust for such extensive use. Since the 2017 progress report, a great deal of progress has been made to identify RFRs and other alternative reference rates in currency areas currently reliant on LIBOR benchmarks, as well as to plan for and in some markets begin to execute transition to those RFRs.
3. *Enhancing contractual robustness*: significant work continues on the part of FSB member authorities, national working groups, ISDA and other trade associations on the important task of strengthening contractual robustness to the risk of discontinuation of major interest rate benchmarks. This issue goes beyond derivatives markets and applies to many types of cash products including syndicated loans, bonds and mortgages.

On 4 December, ICE announced the launch of a survey by ICE Benchmark Administration (IBA) on the use of LIBOR currencies and tenors. The survey on the use of LIBOR is open to all users of LIBOR and will close for responses on 15 February 2019. The purpose of the survey is to identify the LIBOR settings that are most widely used. IBA will use the results of the survey to inform its work in seeking the support of globally active banks for the publication of certain LIBOR settings after year-end 2021.

The primary goal of this work would be to provide those LIBOR settings to users with outstanding LIBOR-linked contracts that are impossible or impractical to modify, while recognising that any such settings would need to be compliant with relevant regulations and in particular those regarding representativeness. However, regardless of the results of the survey, there is no guarantee that any LIBOR settings will continue to be published after year-end 2021, and users of LIBOR should not rely on the continued publication of any LIBOR settings when developing transition or fallback plans.

IBA's work in seeking the support of banks for the publication of certain LIBOR settings after year-end 2021 is also designed to facilitate the industry's work towards an orderly adoption of alternative RFRs into the financial system, as called for by the FCA and the central banks. ICE supports this work and IBA has recently launched the ICE Term RFR Portal and published a paper showing how IBA can support the development of term structures for alternative RFRs. Work on the possible continued publication of certain LIBOR settings is not intended as an alternative to the transition to RFRs for new business.

On 17 December, the Swiss Financial Market Supervisory Authority (FINMA) published guidance detailing the risks of a potential replacement of LIBOR. Many financial products and contracts are dependent on the LIBOR benchmark interest rates, hence the possible elimination of LIBOR from 2021 onwards may be associated with risks, which FINMA has assessed, for supervised institutions. In particular, FINMA sees legal risks, valuation risks and risks in relation to operational readiness for the supervised institutions. FINMA recommends that supervised institutions address the challenges of a potential replacement of LIBOR in good time and, within the scope of its supervisory activities, will discuss the issue of how the institutions can deal with these risks.

On 19 December 2017, ESMA issued an announcement that it would, as from 3 January (ESMA's first working day of 2018), begin publishing registers of administrators, with over 20 now duly registered, and third country benchmarks (none of which have yet been registered), in accordance with Article 36 of the EU BMR.

In view of ESMA's statutory role to build a common supervisory culture by promoting common supervisory approaches and practices, ESMA has established a process for adopting Q&A documents which relate to the consistent application of of the BMR. The most recent update was published on 18 December 2018.

On 20 December, ESMA published its final report on *Guidelines on Non-Significant Benchmarks* under the BMR. This proposes lighter requirements for non-significant benchmarks, their administrators and their supervised contributors in relation to four areas: (i) procedures, characteristics and positioning of oversight function; (ii) appropriateness and verifiability of input data; (iii) transparency of methodology; and (iv) governance and control requirements for supervised contributors. The first three areas are applicable to administrators of non-significant benchmarks while the fourth one is directly applicable to supervised contributors to non-significant benchmarks.

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## Credit rating agencies

On 26 October, the Joint Committee of the three ESAs launched a public consultation, for comment by 31 December, to amend the Implementing Regulations on the mapping of credit assessments of External Credit Assessment Institutions (ECAIs) for credit risk. This is to reflect the outcomes of a monitoring exercise on the adequacy of existing mappings, namely changes to the credit quality steps allocation for two ECAIs and the introduction of new credit rating scales for ten ECAIs. The ESAs also published individual draft mapping reports illustrating how the methodology was applied to produce the amended mappings in line with the CRR mandate.

On 9 November, ESMA issued a public statement in order to raise market participants' awareness on the readiness of CRAs for the possibility of no agreement being reached in the context of the UK withdrawing from the EU. As there is no assurance that a transition period will be agreed, entities using services provided by CRAs need to consider the scenario where a no-deal Brexit would take place on 30 March 2019. CRAs need to have a legal entity registered in the EU and supervised by ESMA, in order for their ratings to be used for regulatory purposes in the EU. In a no-deal Brexit scenario, CRAs established in the UK will lose their EU registration as of the UK's withdrawal date.

On 3 December, ESMA published its annual market share calculation for EU registered CRAs. The purpose of this calculation is to facilitate issuers and related third parties in their evaluation of a CRA with no more than 10% total market share in the EU; since the CRA Regulation (CRAR) requires considering appointment of a CRA with no more than 10% total market share whenever intending to appoint one or more CRAs to rate an issuance or entity. This market share calculation is valid for use from its

**CRAs need to have a legal entity registered in the EU and supervised by ESMA, in order for their ratings to be used for regulatory purposes in the EU.**

date of publication and applicable until the date of publication of the next market share calculation in 2019.

On 19 December, as part of a package of consultations linked to sustainability, ESMA issued a consultation paper, for comment by 19 March 2019, regarding *Guidelines on Disclosure Requirements Applicable to Credit Ratings*. The CRAR includes a number of disclosure requirements relating to the issuance of credit ratings, intended to ensure a sufficient level of transparency around the characteristics of the credit ratings themselves. ESMA has noted an inconsistent level between CRAs regarding the information that is disclosed and believes that it would be beneficial to collate a set of good practices. Besides increasing the quality of these general disclosures, these guidelines have the objective of improving the quality of CRA's disclosures in a manner that provides the users of credit ratings with greater transparency as to whether ESG factors were considered a key underlying element of a credit rating issuance.

On 10 October, ESMA announced the withdrawal of the CRA registration of the Polish SPMW Rating Sp z.o.o. (SPMW). This decision follows the official notification to ESMA by SPMW on 30 August 2018 of its intention to renounce its registration and ESMA confirms that SPMW has effectively stopped its rating activities.

On 3 December, ESMA announced its registration of A.M. Best (EU) Rating Services B.V. as a CRA under the CRAR. A.M. Best (EU) Rating Services B.V. is based in the Netherlands and intends to issue corporate ratings for insurance undertakings and corporate issuers that are not considered a financial institution or an insurance undertaking.

On 14 December, ESMA announced its registration of DBRS Ratings GmbH (DBRS RG) as a CRA under the CRAR. DBRS RG is based in Germany and intends to issue sovereign and public finance ratings; structured finance ratings; and corporate ratings of financials and non-financials. DBRS RG belongs to a group of CRAs and intends to endorse ratings issued by third-country CRAs of the group, based in the US and Canada, where those CRAs are registered by and are subject to the supervision of the respective local competent authorities.

On 20 December, ESMA announced its withdrawal of the CRA registrations of S&P Global Ratings France and S&P Global Ratings Italy following their merger with S&P Global Ratings Europe, based in Ireland.

The total number of CRAs registered in the EU is 27 CRAs – amongst which four operate under a group structure, totaling 17 legal entities in the EU, which means that the total number of CRA entities registered in the EU is 40.

The most recent update to ESMA's Q&A on the application of the EU CRAR was published on 18 December.

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## OTC (derivatives) regulatory developments

On 18 October, ESMA published its first *Annual Statistical Report* on the EU's derivatives markets, based on data submitted under EMIR. This provides the first comprehensive market-level view of these markets, which in Q4 2017 amounted to €660 trillion of gross notional outstanding transactions. At the end of 2017, trade repositories reported a total of 74 million open transactions, including both OTC (86% of the total) and ETD (14%).

In notional terms, interest rate derivatives dominate the market, with 69% of the total amount outstanding, followed by currency derivatives, at 12%. CCP clearing rates for new transactions have been increasing significantly, demonstrating the effectiveness of the EMIR clearing obligation – for all outstanding contracts in Q4 2017, CCP clearing rates were around 27% (25% in Q1 2017) for credit derivatives and 58% (40% in Q1 2017) for interest rate derivatives. The report includes sections on market monitoring; statistical methods; and derivatives market statistics.

On 31 October, ESMA issued a statement relating to the challenges that certain groups, as well as certain non-financial counterparties above the clearing threshold (NFC+), face as of 21 December 2018 to start CCP clearing some of their OTC derivative contracts and trading them on trading venues. From a legal perspective, neither ESMA nor competent authorities possess any formal power to dis-apply a directly applicable EU legal text or even delay the start of some of its obligations. However, in light of outstanding considerations which are already expected to further change the applicable legislative position, ESMA expects competent authorities to generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in this area in a proportionate manner.

On 9 November, ESMA issued a public statement in order to raise market participants' awareness on the readiness of trade repositories (TRs) for the possibility of no agreement being reached in the context of the UK withdrawing from the EU. As there is no assurance that a transition period will be agreed, entities using services provided by TRs need to consider the scenario where a no-deal Brexit would take place on 30 March 2019. Derivatives subject to the reporting obligation under EMIR must be reported to a registered EU-established TR or a recognised third-country TR. In a no-deal Brexit scenario, TRs established in the UK will lose their EU registration as of the UK's withdrawal date.

On 15 November, the FSB, in conjunction with the CPMI and IOSCO, issued a discussion paper seeking comment, by 1 February, on considerations that may be relevant to evaluating whether existing financial resources and tools are adequate to implement resolution strategies for individual CCPs; and considerations that could guide authorities in developing possible approaches to the treatment of CCP equity in resolution. It builds on the *FSB Key Attributes of Effective Resolution Regimes for Financial Institutions* and *FSB Guidance on CCP Resolution and Resolution Planning*. The FSB has concluded that further guidance on the necessary financial resources should be developed in an evidence-based way including by drawing on the practical experience gained from resolution planning by relevant authorities and Crisis Management Groups.

On 19 November, the FSB, BCBS, CPMI and IOSCO published their final report on *Incentives to Centrally Clear OTC Derivatives*. Prepared by the Derivatives Assessment Team (DAT), this report evaluates the interaction of post-crisis reforms, directly or indirectly, relevant to incentives to CCP clear, and how they could affect incentives. The findings of this report will inform relevant standard-setting bodies and, if warranted, could provide a basis for fine-tuning post-crisis reforms, bearing in mind the original objectives of the reforms.

> **Some categories of clients have less strong incentives to use CCP clearing, and may have a lower degree of access to CCP clearing.**

The report confirms the findings of an earlier consultative document (in respect of which an overview of responses has also been published):

- The changes observed in OTC derivatives markets are consistent with the G20 Leaders' objective of promoting CCP clearing as part of mitigating systemic risk and making derivatives markets safer.
- The relevant post-crisis reforms, in particular the capital, margin and clearing reforms, taken together, appear to create an overall incentive, at least for dealers and larger and more active clients, to CCP clear OTC derivatives; but some categories of clients have less strong incentives to use CCP clearing, and may have a lower degree of access to CCP clearing.
- Non-regulatory factors, such as market liquidity, counterparty credit risk management and netting efficiencies, are also important and can interact with regulatory factors to affect incentives to CCP clear.
- The provision of client clearing services is concentrated in a relatively small number of bank-affiliated clearing firms and this concentration may have implications for financial stability; and some aspects of regulatory reform may not incentivise provision of client clearing services.

The DAT's work suggests that the treatment of IM in the leverage ratio can be a disincentive for banks to offer or expand client clearing services and that, bearing in mind the original objectives of the reform, additional analysis would be useful to further assess these effects. In this regard, on 18 October, the BCBS issued a public consultation (for comment by 16 January) setting out options for adjusting, or not, the leverage ratio treatment of client cleared derivatives. The report also discusses the effects of clearing mandates and margin requirements for non-CCP cleared derivatives (particularly IM) in supporting incentives to CCP clear; and the treatment of client cleared trades in the framework for G-SIBs.

Also on 19 November, the FSB published:

1. *OTC Derivatives Market Reforms: Progress Report on Implementation*, which indicates that, overall, good progress continues to be made across the G20's OTC derivatives reform agenda in the period from

end-June 2017, including work to assess whether the implemented reforms meet the intended objectives. The report finds that:

(i) 21 out of 24 FSB member jurisdictions have comprehensive trade reporting requirements in force, with authorities using trade repository data for a wide range of tasks, and incorporating it in their published work;

(ii) 18 member jurisdictions now have in force comprehensive standards/criteria for determining when standardised OTC derivatives should be CCP cleared, and two more jurisdictions adopted mandatory clearing requirements during the reporting period;

(iii) 16 jurisdictions have implemented comprehensive margin requirements for non-CCP cleared derivative (NCCDs), an increase of two;

(iv) interim higher capital requirements for NCCDs are in force in 23 of the 24 member jurisdictions, however, the number of jurisdictions that have implemented the final standardised approach for counterparty credit risk and capital requirements for bank exposures to CCPs is much lower;

(v) 13 jurisdictions have in force comprehensive assessment standards or criteria for determining when products should be platform traded, with new determinations having entered into force for specific derivatives products to be executed on organised trading platforms in six jurisdictions; and

(vi) jurisdictions reported continuing progress, both in establishing broad legal powers to exercise deference with regard to foreign jurisdictions' regimes, but more particularly with regard to exercising those powers in particular cases – notably, the EU and US (CFTC)) recognised each other's regulatory regime for trading venues, while Australia, Japan and the US (CFTC) recognised one or more jurisdictions for the purposes of their margin requirements.

2. *Trade Reporting Legal Barriers: Follow-up of 2015 Peer Review Recommendations*, which reports on actions FSB member jurisdictions have taken to address identified legal barriers to reporting and accessing trade data. This progress report finds that:

   (i) all but three of the FSB's member jurisdictions have removed or addressed barriers to full trade reporting;

   (ii) five FSB member jurisdictions allow masking of counterparty identifiers for a relatively low proportion of transactions; and

   (iii) in 12 jurisdictions, changes have been made or are underway to address or remove barriers to access to trade repository data by foreign authorities and/or non-primary domestic authorities, including legal barriers which have only very recently been removed.

On 18 December, the ESAs published two joint draft RTS, to amend the RTS on the clearing obligation and risk mitigation techniques for non-cleared OTC derivatives. These standards provide a specific treatment for STS securitisation, to ensure a level playing field with covered bonds, and are required for the proper implementation of EMIR. In particular, the draft RTS on risk mitigation techniques amend the existing RTS by extending the special treatment currently associated with covered bonds to STS securitisations. The treatment, which allows no exchange of IM and only collection of VM, is applicable only where an STS securitisation structure meets a specific set of conditions equivalent to the ones required for covered bonds issuers to be so treated.

Dated 19 December, the European Commission has adopted a Delegated Regulation with regard to RTS on the clearing obligation, to extend the dates of deferred application of the clearing obligation for certain OTC derivatives. Under EMIR, intragroup transactions may be exempted from the clearing obligation; and intragroup transactions with a third country entity may also be exempted if the Commission has adopted an equivalence decision for the third country where the relevant group entity is established – but no such decisions have as yet been adopted.

The three Delegated Regulations on the clearing obligation include a provision related to intragroup transactions with a third country entity, providing for a deferred date of application of up to three years in the absence of the relevant equivalence decision – with the soonest deferral date being 21 December 2018. This new Delegated Regulation introduces a modification to the three existing RTS on the clearing obligation to extend the applicable deferral dates to 21 December 2020. Following formal approval, this new Delegated Regulation will enter into force on the day following that of its publication in the *Official Journal*.

In view of ESMA's statutory role to build a common supervisory culture by promoting common supervisory approaches and practices, ESMA has established a process for adopting Q&A documents which relate to the consistent application of EMIR. The first version of ESMA's EMIR Q&A document was published on 20 March 2013, with the most recent update having been published on 3 December.

ESMA's list of CCPs authorised to offer services and activities in the EU, in accordance with EMIR, has not been updated since 9 August, and its list of third-country CCPs recognised to offer services and activities in the EU has not been updated since 21 August. ESMA's *Public Register for the Clearing Obligation* under EMIR was last updated on 6 December; whilst its (non-exhaustive) list of CCPs established in non-EEA countries which have applied for recognition has not been updated since 19 June.

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## Market infrastructure

### *ECB: TARGET2-Securities (T2S) operations*

Over the weekend of 29-30 October the Danish CSD, VP Securities, migrated its settlement activity in DKK to T2S. At the same time, the Danish central bank connected its real-time gross settlement (RTGS) and collateral management system, Kronos2, to T2S. The successful migration has been an important milestone for T2S as it is the first time that a currency other than euro is available for DvP settlement in T2S.

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In addition, two new CSDs from within the euro area also joined T2S: the Central Bank of Ireland and a newly established French CSD, ID2S. With the addition of these, a total of 22 CSDs are now connected to the common settlement platform.

On 17 October, the ninth edition of the T2S Harmonisation Progress Report was published. The Report reiterates that a lot of progress has been achieved but that the long road to harmonisation triggered by the T2S project is not concluded yet. Overall, compliance with the 17 T2S harmonisation standards has now reached 85%, but important gaps still remain, in particular in relation to corporate actions.

Following up on discussions in mid-2018 around the T2S pricing review, AMI-SeCo members decided to initiate more detailed work to better understand the evolution of T2S volumes and the different driving forces behind it. Following a couple of initial workshops, a small group of AMI-SeCo members chaired by Nicholas Hamilton, co-chair of the ICMA ERCC Operations Group, are working on a draft report on this topic which should be presented to the wider group in May 2019.

For a more detailed recap of the first full year of T2S operations, we invite readers to have a look at the latest T2S Special Series which was published on 20 December and includes comments from many key T2S stakeholders, including central bankers as well as market users.

### *ECB: advisory groups on market infrastructure*

The ECB's two advisory groups on market infrastructure, AMI-SeCo and AMI-Pay, both had their latest meeting on 20 November. The groups had a joint meeting in the morning to cover the common topics and ensure good coordination between the groups. This was followed by separate sessions of both groups in the afternoon to discuss topics more specific to each group. Agendas, summaries and meeting documents of all three sessions are available on the ECB website.

As usual, discussions covered a wide range of topics. During the joint session members discussed the initiatives that are relevant across both payments and securities, including the T2S-T2 consolidation project and work in relation to cyber resilience (see more details on both below). In addition, members reviewed the broader work on post-trade harmonisation beyond the ECB infrastructure. The European Commission and ESMA, both observers in the group, provided a useful status update on the various regulatory initiatives of relevance, including CSDR, SFTR, Shareholders Rights, withholding tax and others.

In the individual sessions, both groups covered initiatives more relevant in their respective area of focus. In the case of AMI-SeCo, members reviewed in detail the operations of T2S, received an update from the various sub-groups, including the HSG's FinTech Task Force and the CSD Steering Group and also discussed in detail progress in relation to the ECMS project and the supporting work on collateral management harmonisation (see below).

### *ECB: ECMS and collateral management harmonisation*

One area of particular focus for AMI-SeCo is the extensive harmonisation work in relation to collateral management which has been launched in preparation for the go-live of the Eurosystem Collateral Management System (ECMS), which is scheduled to go live in November 2022. The ECMS which will establish a single system to manage eligible assets used as collateral for Eurosystem credit operations, requires a substantial harmonisation effort. This work is coordinated by a dedicated Task Force on Collateral Management Harmonisation (CMH-TF). The group was launched in early 2017 by AMI-SeCo members and includes several members of the ERCC Operations Group, who have been actively contributing to the different CMH-TF work streams that have been established.

**The ECMS, which will establish a single system to manage eligible assets used as collateral for Eurosystem credit operations, requires a substantial harmonisation effort.**

While the scope of the work is not limited to areas of specific relevance for the ECMS, this has clearly been the initial focus. In particular, important progress has been made in relation to the harmonisation of tri-party and corporate action processes. Reports with detailed harmonisation proposals in both areas have been prepared and approved by AMI-SeCo in June. The group now focuses on the implementation of these proposals and is currently undertaking further consultations in order to specify certain aspects, in particular in relation to corporate actions.

### *ECB: other market infrastructure-related initiatives*

While the development of the ECMS is one key priority, there are a number of other important ECB initiatives under way in the area of market infrastructure. In particular, the ECB seeks to further develop and improve its services offered in relation to the TARGET infrastructure. One such initiative is the development of the TARGET Instant Payment Settlement (TIPS) service, an extension of existing payment services related to the TARGET2 platform which will enable payment service providers to offer fund transfers to their customers on a real-time basis and 24/7. On 30 November 2018, two years after the launch of this initiative and following extensive testing, the TIPS service successfully went live, with initially eight banks connected. The Banca d'Italia hosted a TIPS launch ceremony in Rome.

Another essential piece in the Eurosystem's market infrastructure strategy is the ongoing integration of TARGET2 payment services with the T2S platform for securities settlement. The project was launched in September 2016, at the same time as the TIPS initiative, with the consolidated platform scheduled to go live in November 2021. The project has progressed well with the adoption of extensive user requirements in December 2017. More recently, on 6 December, two further detailed documents have been published setting out separately the functional specifications of both the new RTGS platform as well as the related central liquidity services.

Apart from developing its services, another priority for the Eurosystem in the area of market infrastructure is cyber resilience. As part of this work the ECB is looking at FMIs specifically. In March 2018, the ECB's Governing Council approved the new *Eurosystem Cyber Resilience Strategy for FMIs* and established at the same time a new forum for strategic discussions between the relevant FMIs, the Euro Cyber Resilience Board. In the context of this work, the ECB undertook over summer a market-wide crisis communication exercise based on the hypothetical scenario of a cyber-attack on major euro area FMIs resulting in a loss of data integrity. On 14 December, the final report from this exercise was published.

### *ECB: market contact groups*

Members of the Bond Market Contact Group (BMCG) last met on 9 October in Frankfurt. Members discussed the bond market outlook for the year ahead, based on a presentation by BNP Paribas. Another topic on the agenda was the electronification of bond markets and the impact of MiFID II. This discussion was introduced by Tradeweb and Goldman Sachs. A third major topic discussed at the latest BMCG meeting was Brexit and the related risks for the bond market. On the latter issue, Paul Richards, ICMA's Head of Market Practice and Regulatory Policy, provided an introductory presentation, focusing on cliff-edge risks in international capital markets. All meeting documents as well as a summary of the meeting are available on the ECB's website. The next regular meeting of the BMCG is scheduled for 12 February 2019.

The latest meeting of the Money Market Contact Group (MMCG) was held on 3 December in Frankfurt. According to the meeting agenda members covered a wide range of topics, including Brexit, in particular its potential impacts on credit ratings; market expectations in relation to monetary policy; structural developments in FX swaps market and banks' USD funding; as well as the impact of different regulatory initiatives on money markets. Members also received an update from the ECB on the recent go-live of TIPS and discussed recent progress in relation to benchmark reforms in the euro area.

The related meeting documents should be available shortly. The next quarterly meeting of the MMCG will be held in Q1 2019.

### European Commission

Following up on the important work of the European Post-Trade Forum (EPTF), an industry expert group established by the Commission in 2016 to reassess existing post-trade barriers, the Commission reached out to the different members of the group with a questionnaire. The objective of the questionnaire is to collect more quantitative information on the different issues raised by the EPTF Report and the subsequent public consultation which concluded in November 2017. The deadline for the informal consultation is 15 January and ICMA is currently assessing whether to submit a short response.

On 13 December, the European Commission adopted a set of long-awaited technical standards related to the implementation of the EU SFT Regulation, which are now subject to a 3-month scrutiny by European Parliament and Council before publication in the *Official Journal* and entry into force. SFTR reporting will go live after a further transition period of at least 12 months, ie in April 2020. (For further details, see Repo and Collateral section above.)

### ESMA: post-trading

ESMA continues to provide guidance in relation to the implementation of the CSD Regulation (CSDR). This includes regular updates to the CSDR Q&As, the latest batch of which was issued on 12 November. The update covers two areas: CSDs' provision of services in other Member States and settlement discipline (cash penalties).

In parallel, the authorisation process for CSDs under the new regime is well under way. National regulators are busy assessing applications by their domestic CSDs to get authorised under CSDR, while ESMA is maintaining a central register to track any authorisations granted. Two more CSDs have been added to the register since the last Quarterly Report, bringing the total to eight. Among the new entrants to the list is ID2S, a new CSD authorised in France and looking to provide DLT-based settlement solutions in relation to the Negotiable European Commercial Paper (NEU CP) market.

Furthermore, on 30 December, ESMA published two consultation papers on settlement fails reporting (under Article 7(1) CSDR) and standardised procedures and messaging protocols (under Articles 6(2) CSDR), as a first step to develop more detailed Guidelines on both of these issues.

### Global Legal Entity Identifier System

On 11 December, the Global LEI Foundation (GLEIF) published the Beta Version of an updated LEI Search Tool 2.0 which has been developed to provide easier access and enhanced search options in relation to the large LEI database maintained by the GLEIF and freely accessible on their website. An updated list of all LEI registration authorities around the world, currently around 690, is also available on the GLEIF website.

In the meantime, the total number of LEIs issued globally continues to grow, albeit at a slower pace than in the run-up to the implementation of MiFID II in Europe in January 2018. This was hardly surprising given the strict requirements in relation to LEIs introduced by MIFID II, which caused an expected last-minute run on LEIs. Since then, average monthly issuance has stabilised at about 20,000 LEIs in 2018, with the biggest growth rates recorded in India, Mexico and Australia. The total number of LEIs issued has reached 1.33 million (December 2018). The GLEIF's Global Business Reports provide regular updates and statistics on the global issuance of LEIs.

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# FinTech in International Capital Markets

by Gabriel Callsen

## FinTech regulatory developments

### *EBA: consultation on guidelines on ICT and security risk management*

On 13 December 2018, the European Banking Authority (EBA) launched a consultation on its draft *Guidelines on ICT and Security Risk Management*. These Guidelines establish requirements for credit institutions, investment firms and payment service providers (PSPs) on the mitigation and management of their information and communication technology (ICT) risks and aim to ensure a consistent and robust approach across the Single market. The consultation runs until 13 March 2019.

### *BCBS: cyber-resilience – range of practices report*

On 4 December 2018, the Basel Committee on Banking Supervision (BCBS) published the report, *Cyber-Resilience: Range of Practices*. It identifies, describes and compares the range of observed bank, regulatory and supervisory cyber-resilience practices across jurisdictions. Based on analysis of authorities' responses to previous international surveys and on exchanges between international experts, the report gains insight into the effective practices and expectations in place. It also benefited from industry participants' input. The current challenges and initiatives to enhance cyber-resilience are summarised in 10 key findings and illustrated by case studies which focus on concrete developments in the jurisdictions covered.

### *ECB: publication of the cyber resilience oversight expectations*

On 3 December 2018, the European Central Bank (ECB) published the *Final Cyber Resilience Oversight Expectations for Financial Market Infrastructures (FMIs)*. Cyber resilience is an important aspect of FMIs' operational resilience and is thus also a factor affecting the overall resilience of the financial system and the broader economy. The cyber resilience oversight expectations are based on the global guidance on cyber resilience for financial market infrastructures. This guidance was published by the Committee on Payments and Market Infrastructures and the Board of the International

Organisation of Securities Commissions (CPMI-IOSCO) in June 2016.

### IMF: casting light on central bank digital currencies

On 12 November 2018, the International Monetary Fund (IMF) published the report, *Casting Light on Central Bank Digital Currencies* (Staff Discussion Notes No. 18/08). Digitalisation is reshaping economic activity, shrinking the role of cash, and spurring new digital forms of money. Central banks have been pondering whether and how to adapt. One possibility is central bank digital currency (CBDC) – a widely accessible digital form of fiat money that could be legal tender. This discussion note proposes a conceptual framework to assess the case for CBDC adoption from the perspective of users and central banks. It discusses possible CBDC designs, and explores potential benefits and costs, with a focus on the impact on monetary policy, financial stability, and integrity. This note also surveys research and pilot studies on CBDC by central banks around the world.

### ESMA SMSG advice: own initiative report on initial coin offerings and crypto assets

On 19 October 2018, ESMA's Securities and Markets Stakeholder Group (SMSG) issued its *Own Initiative Report on Initial Coin Offerings and Crypto-Assets*. The goal of this report was to give advice to ESMA on steps it can take to contain the risks of ICOs and crypto assets, on top of existing regulation. Since there are no obvious stability risks yet in this respect, this report mainly focuses on risks for investors. The first part of the report provides necessary background information. It first defines the relevant concepts. The report then provides a taxonomy of crypto assets, distinguishing between payment tokens, utility tokens, asset tokens and hybrids. In order to inspire potential regulatory initiatives, the report further provides an overview of recent ICOs of crypto assets and of the most important existing regulations of crypto assets in the EU. The second part of the report builds up to advice to ESMA on the question whether and how ICO's and/or crypto assets should be regulated.

### IMF and World Bank: launch of the Bali FinTech Agenda

On 11 October 2018, the International Monetary Fund (IMF) and the World Bank launched the Bali FinTech Agenda, a set of 12 policy elements aimed at helping member countries to harness the benefits and opportunities of rapid advances in financial technology that are transforming the provision of banking services, while at the same time managing the inherent risks. The Agenda proposes a framework of high-level issues that countries should consider in their own domestic policy discussions and aims to guide staff from the two institutions in their own work and dialogue with national authorities. The 12 elements were distilled from members' own experiences and cover topics relating broadly to enabling FinTech; ensuring financial sector resilience; addressing risks; and promoting international cooperation.

### FSB: crypto asset markets - potential channels for future financial stability implications

On 10 October 2018, the Financial Stability Board (FSB) published *Crypto-Asset Markets: Potential Channels for Future Financial Stability Implications*. This report sets out the analysis behind the FSB's proactive assessment of the potential implications of crypto-assets for financial stability. The report follows up on the initial assessment set out in the FSB Chair's March 2018 letter to G20 Finance Ministers and Central Bank Governors, and the summary of the work of the FSB and standard-setting bodies on crypto-assets the FSB published in July. The FSB's report includes an assessment of the primary risks present in crypto assets and their markets, such as low liquidity, the use of leverage, market risks from volatility, and operational risks. Based on these features, crypto assets lack the key attributes of sovereign currencies and do not serve as a common means of payment, a stable store of value, or a mainstream unit of account. Based on the available information, crypto assets do not pose a material risk to global financial stability at this time. However, vigilant monitoring is needed in light of the speed of market developments.

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# ICMA Capital Market Research

*The GFMA and ICMA Repo Market Study: Post-Crisis Reforms and the Evolution of the Repo and Broader SFT Markets*
**Published:** 17 December 2018
**Authors:** ICMA/GFMA Joint Report

*MiFID II/R and the Bond Markets: the First Year*
**Published:** 6 December 2018
**Editor:** Andy Hill, ICMA

*Adopting International Practices of Bond Trustee Arrangements in China*
**Published:** 5 December 2018
**Authors:** ICMA/NAFMII Joint Publication

*ICMA Discussion Paper: CSDR Mandatory Buy-Ins and Securities Financing Transactions*
**Published:** 3 October 2018
**Author:** Andy Hill, ICMA

*ICMA Briefing: Regulatory Approaches to FinTech and Innovation in Capital Markets*
**Published:** 7 September 2018
**Author:** Gabriel Callsen, ICMA

*The Asia-Pacific Cross-Border Corporate Bond Secondary Market: A Report on the State and Evolution of the Market*
**Published:** 30 August 2018
**Authors:** Andy Hill and Mushtaq Kapasi, both ICMA

*How to Survive in a Mandatory Buy-in World*
**Published:** 26 June 2018
**Author:** Andy Hill, ICMA

*The European Corporate Single Name Credit Default Swap Market: A Study into the State and Evolution of the European Corporate SN-CDS Market*
**Published:** 15 February 2018
**Authors:** Andy Hill and Gabriel Callsen, both ICMA

*ICMA ERCC Briefing Note: The European Repo Market at 2017 Year-End*
**Published:** 15 January 2018
**Author:** Andy Hill, ICMA

*The Panda Bond Market and Perspectives of Foreign Issuers*
**Published:** 19 October 2017
**Authors:** ICMA/NAFMII Joint Report

*Market Electronification and FinTech*
**Published:** 3 October 2017
**Author:** Gabriel Callsen, ICMA

*Use of Leverage in Investment Funds in Europe*
**Published:** 19 July 2017
**Authors:** AMIC/EFAMA Joint Paper

*European infrastructure finance: a Stock-Take*
**Published:** 13 July 2017
**Authors:** ICMA/AFME Joint Paper

*The European Credit Repo Market: The Cornerstone of Corporate Bond Market Liquidity*
**Published:** 22 June 2017
**Author:** Andy Hill, ICMA

*Closed for Business: A Post-Mortem of the European Repo Market Break-Down over the 2016 Year-End*
**Published:** 14 February 2017
**Author:** Andy Hill, ICMA

*The Counterparty Gap: A study for the ICMA European Repo and Collateral Council on the Trade Registration Models used by European Central Counterparties for Repo Transactions*
**Published:** 27 September 2016
**Author:** Prepared for ICMA by John Burke, independent consultant

*Remaking the Corporate Bond Market: ICMA's 2nd Study into the State and Evolution of the European Investment Grade Corporate Bond Secondary Market*
**Published:** 6 July 2016
**Author:** Andy Hill, ICMA

*Evolutionary Change: The Future of Electronic Trading in European Cash Bonds*
**Published:** 20 April 2016
**Author:** Elizabeth Callaghan, ICMA

*Perspectives from the Eye of the Storm: The Current State and Future Evolution of the European Repo Market*
**Published:** 18 November 2015
**Author:** Andy Hill, ICMA

*Impact Study for CSDR Mandatory Buy-ins*
**Published:** 24 February 2015
**Author:** Andy Hill, ICMA

*The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market*
**Published:** 25 November 2014
**Author:** Andy Hill, ICMA

*Continually Working to Develop Efficient and Effective Collateral Markets*
ERC Occasional Paper
**Published:** 4 September 2014
**Author:** David Hiscock, ICMA

*Covered Bond Pool Transparency: the Next Stage for Investors*
**Published:** 21 August 2014
**Author:** Prepared for ICMA by Richard Kemmish Consulting Ltd

*Collateral is the New Cash: The Systemic Risks of Inhibiting Collateral Fluidity*
**Published:** 3 April 2014
**Author:** Andy Hill, ICMA

Events & Education

ICMA Women's Network
Networking. Progression. Support.

# Sustainability: the perspective of influential women in the rapidly growing ESG market

The IWN is grateful to HSBC for generously hosting the IWN on 1 November. Alexi Chan, Global Co-head of Capital Markets, HSBC, provided an insight into HSBC's efforts to increase the presence of women across the firm, acknowledging the importance of this to the industry as a whole.

Mandy DeFilippo, Chair of ICMA and Head of Risk Management for Fixed Income & Commodities, EMEA, Morgan Stanley, gave a quick update on the work of the IWN, and highlighted that sustainable finance is a key pillar of ICMA's strategy and, as custodian of the Green Bond Principles, ICMA is at the forefront of developments in this rapidly growing market.

Margaret Kuhlow, Finance Practice Head of the World Wildlife Fund (WWF) then introduced the WWF as the world's largest environmental organisation, setting the context by putting a value on some of our precious natural resources, such as the estimated $125 trillion worth of trees on the planet. A significant growth in policy interventions has led to the issuance of more than 1,500 ESG bonds – but $200-300 billion of issuance per year is needed to address the planet's environmental challenge. Referring to the WWF's Living Planet Report, Margaret highlighted the scale of this challenge; World Overshoot Day – the day of the year on which we use up the resources that the planet can produce in one year - was in December in 1970, but this year it fell in August, so we must not assume that the resources we need will always be there. The WWF's focus is on stabilising the climate, stabilising populations and reducing inequity, and stabilising the biosphere. Whilst alerting us to the scale of the problem, Margaret stressed that it is not too late to make a difference; but more action, together with more green finance, is needed.

During the panel discussion moderated by Mandy, with Margaret and alongside Farnam Bidgoli, Associate, DCM Sustainable Bonds, HSBC, and Ingrid Holmes, Head of Policy, Hermes Investment Management, the panelists' passion for sustainable finance was tangible. Each of the panelists emphasised the importance of confidence. If someone offers you a role, they have already assessed you and your capabilities, so don't talk yourself out of it! It is important to advocate for yourself and remember that, if you don't ask, you don't get. An interesting angle to emerge was that encouraging more flexibility for men in the workplace will have a knock-on effect for women; if a man finds it hard to ask for time off, it will also be hard for women. A final very practical piece of advice was to engage in activities outside work that demonstrate your passion – eg attend talks and lectures or take courses which help show (and nurture) your interest in a particular area.

The networking event that followed the panel was a great opportunity to continue discussions and meet new people; it was gratifying to learn that one member firm is encouraging all its graduate trainees (both male and female) to come to IWN events for precisely this reason.

The ICMA Women's Network has already scheduled three networking events around Europe in the first quarter of 2019.

- Building a career path with leadership and confidence, in Copenhagen on 16 January
- Quand les femmes investissent la haute fonction publique, in Paris on 4 February
- Developing your career with confidence and leadership, in Brussels on 27 February

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# ICMA Future Leaders

2018 was a busy year for the Future Leaders – with more than seven networking events on different themes organised in financial centres around Europe, all of them designed to enable individuals from member firms to meet and get to know their colleagues in the industry who are also starting out on careers in finance.

The first Future Leaders event of 2019 will be in Madrid in January.

Our online mentoring platform continues to bring together mentors and mentees in the cross-border fixed income space, with over 100 mentoring relationship currently operating.

We also hope you are enjoying the new quarterly newsletter from the Future Leaders, intended as a quick update on some of the issues ICMA is working on and to explain some of the benefits of membership which can have career enhancing effects!

**Contact: futureleaders@icmagroup.org**

# The winner of the IFL Essay Competition

This summer ICMA asked young professionals with a maximum of eight years of experience in financial markets to write an essay on the broad theme "How will the international bond markets look in 10 years' time?", thinking ahead to ICMA's 60th anniversary in 2028.

The ICMA Executive Committee, Market Practice and Regulatory Policy team and representatives of the Future Leaders Committee have chosen the winning essay written by, Alexander Malitsky of TD Securities, who will receive the €3,000 prize and also have the opportunity to present his paper to the ICMA Board.

Alexander introduced his essay as "another boring big data paper from a millennial telling me how Snapchat will take over the global bond markets". Of course, his essay is far from boring, refreshingly challenging the current status quo of (under)usage of data, and presenting a realistic evolution of Debt Capital Markets anchored in more personal and insightful interactions with clients through a fully efficient gathering and categorising of any data available.

In his conclusions, he wonders whether bankers really have to invest in a clearer and more thorough data pool; whether issuers really care about the "true" insights a bank has, or whether it is actually a "people business" and soft-selling skills that are actually much more important than the thorough analysis of investor behaviour and markets; and more importantly whether this is really going to lead to more mandates and more business. Interesting discussion points for the ICMA Board to ponder looking ahead at the next 10 years.

# Diary 2019

| DATE | ICMA Workshops & Courses |
| --- | --- |
| 7 February *Register* | **NEW for 2019 - Intensive One-Day Workshop: Repo & the European Repo Market, London, 7 February** Short, comprehensive and therefore intensive training for those requiring a detailed familiarisation with repo and the repo market and who do not have two or three days to spare. Suitable for staff from all departments of a repo market participant and those supporting market participants with services such as legal advice and technology. |
| 11-12 February *Register* | **Introduction to Green Bonds, London, 11-12 February** This two-day course from ICMA provides a thorough and practically oriented introduction to the essentials of green bonds. Developed and delivered by a combination of leading market practitioners and ICMA's green bond experts, the material also benefits from input from members of the GBP Executive Committee, comprising the elected representatives of the most significant issuers, investors and underwriters in the green bond market. |
| 25-27 February *Register* | **Repo and Securities Lending under the GMRA and GMSLA, London, 25-27 February** Analyses how repo and securities lending transactions operate within the framework provided by the Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA) and highlights the issues that need to be addressed by users. These two separate, but increasingly overlapping, master agreements are the essential underpinnings of the cross-border repo and securities lending markets. |
| 12 March *Register* | **Bond syndication Practices for Compliance Professionals and Middle Office Professionals, London, 12 March** This workshop aims to give compliance professionals an in-depth and thorough understanding of the 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. |
| 14 March *Register* | **European Regulation: An Introduction for Capital Market Practitioners, London, 14 March** How much do you know about the new regulations that are already in force and impacting your daily work in the capital market and the ones that are still in the pipeline? How do the institutions of Europe work together to develop new regulation? ICMA's one-day, fast-track course on European regulation for capital market practitioners gives an overview of the new regulatory landscape for financial institutions in Europe. |
| 3-4 June *Register* | **GMRA Masterclass – a Clause-by-Clause Analysis & Annex I Negotiation, London, 3-4 June** This two-day advanced-level workshop systematically reviews the Global Master Repurchase Agreement (GMRA) 2011 clause by clause, giving a thorough grounding in all of its key provisions and the most commonly-used Annexes. An experienced repo negotiator conducts a case study of a typical negotiation of Annex I, offering hints and tips on the most effective approach for both sell-side and buy-side counterparties. |

# Diary 2019

| DATE | ICMA Conferences |
|---|---|
| 31 January *Register* | **ICMA European Repo and Collateral Council Annual General Meeting, Luxembourg, 31 January** Yves Mersch, Executive Board Member of the European Central Bank, will be our featured keynote speaker at the 2019 ICMA ERCC AGM on 31 January. |
| 6 February *Register* | **ICMA & NCMF Joint Annual Conference: Sustainability, IBOR transition, Brexit – key issues for the EU capital market, Helsinki, 6 February** The 2019 conference will look at developments in the Nordic bond markets within the European context. |
| 26 February *Register* | **ICMA Asia Primary Market Seminar & Forum, Hong Kong, 26 February** With a strong emphasis on developments in global markets and the coordination of regulatory reform and featuring high-level expert speakers from the region, the event is catered to debt capital market professionals across origination, syndicate, legal, compliance and operations areas. |
| 4 March *Register* | **Japan Securities Summit, London, 4 March** The summit, featuring contributions from high profile speakers from the Japanese market, government and central bank, will provide European investors and financial market professionals with the outlook for the Japanese economy and the latest developments in the Japanese securities market with particular focus on issues affecting sustainable growth as well as the potential impacts of Brexit. |
| 7 March *Save the date* | **ICMA Primary Market Forum, Mumbai, 7 March** The ICMA Primary Market Forum in Mumbai, hosted by YES Bank, will bring together issuers, syndicate banks, investors and law firms active in primary debt capital markets to showcase work by ICMA and its members on the regulatory and market practice issues unique to Asian capital markets. |
| 13 March *Register* | **ICMA MENA Bond Market Trends & New Products, Manama, Bahrain, 13 March** Drawing together international experts and market participants from the GCC this conference will look at major developments in global and MENA bond markets. |
| 20 March *Register* | **ICMA Secondary Market Forum, Paris, 20 March** The forum will be an opportunity to hear, and participate in, discussions on the critical issues facing the European bond markets and the key drivers of evolving market structure, including MiFID II/R, the unwinding of ECB quantitative easing, the practical implications of Brexit, developments in technology and electronic trading, as well as the rapidly evolving economic and geopolitical landscape. |

**Save the dates**

**ICMA Annual General Meeting and Conference 2019, Stockholm, 15-17 May** Registrations open in February 2019

**2019 Green Bond Principles and Social Bond Principles Annual General Meeting and Conference, Frankfurt, 13 June** Registrations open in March 2019

**For more info please contact: icmaevents@icmagroup.org or visit icmagroup.org/events**

Courses 2019

ICMA Executive Education

# The best CPD for you

Continuous Professional Development, or CPD, is the regular improvement of knowledge and skills undertaken by professionals during their career. In our constantly changing industry CPD is a real differentiating factor that sets you apart from the rest.

CPD takes many forms, from training courses, to online learning as well as events or workshops. When choosing CPD, you should consider factors like:

- Your preferred method of learning.
- Your availability and commitment.
- Your goals – are you looking to increase your professional status with a recognised qualification? Or fill some gaps in knowledge? Or is it part of your overall professional strategy to become a specialist in a topic?

If you are part of the ICMA Future Leaders initiative, you are already plugged into an association with a great industry reputation that offers a variety of CPD products, from recognised qualifications, to specialist programmes, workshops and events; you can take courses online or watch one of our webinars, or you may prefer a face-to-face course that offer additional networking opportunities.

Visit www.icmagroup.org/EE or contact education@icmagroup.org and find out about CPD with us.

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Securities Operations Foundation Qualification (SOFQ)
Brussels 6-8 March

Operations Certificate Programme (OCP)
Brussels 11-15 March

Collateral Management
London 1-2 April

Securitisation – An Introduction
London 8-9 April

Fixed Income Portfolio Management
London 23-24 May

OTC Derivatives Operations – Products, Collateral & EMIR
London 27-28 June

Securities Lending & Borrowing
London 17-18 June

**For more info, please contact: education@icmagroup.org or visit www.icmagroup.org/education**

# GLOSSARY

| | |
|---|---|
| ABCP | Asset-Backed Commercial Paper |
| ABS | Asset-Backed Securities |
| ADB | Asian Development Bank |
| AFME | Association for Financial Markets in Europe |
| AIFMD | Alternative Investment Fund Managers Directive |
| AMF | Autorité des marchés financiers |
| AMIC | ICMA Asset Management and Investors Council |
| AMI-SeCo | Advisory Group on Market Infrastructure for Securities and Collateral |
| APP | ECB Asset Purchase Programme |
| ASEAN | Association of Southeast Asian Nations |
| AuM | Assets under management |
| BCBS | Basel Committee on Banking Supervision |
| BIS | Bank for International Settlements |
| BMCG | ECB Bond Market Contact Group |
| BMR | EU Benchmarks Regulation |
| bp | Basis points |
| BRRD | 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 |
| CMU | Capital Markets Union |
| CNAV | Constant net asset value |
| CoCo | Contingent convertible |
| COP21 | Paris Climate Conference |
| COREPER | Committee of Permanent Representatives (in the EU) |
| CPMI | Committee on Payments and Market Infrastructures |
| 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 Depositories Regulation |
| DCM | Debt Capital Markets |
| DLT | Distributed ledger technology |
| DMO | Debt Management Office |
| D-SIBs | Domestic systemically important banks |
| DVP | Delivery-versus-payment |
| EACH | European Association of CCP Clearing Houses |
| EBA | European Banking Authority |
| EBRD | European Bank for Reconstruction and Redevelopment |
| ECB | European Central Bank |
| ECJ | European Court of Justice |
| ECOFIN | Economic and Financial Affairs Council (of the EU) |
| ECON | Economic and Monetary Affairs Committee of the European Parliament |
| ECP | Euro Commercial Paper |
| ECPC | ICMA Euro Commercial Paper Committee |
| EDGAR | US Electronic Data Gathering, Analysis and Retrieval |
| EEA | European Economic Area |
| EFAMA | European Fund and Asset Management Association |
| EFC | Economic and Financial Committee (of the EU) |
| EFSF | European Financial Stability Facility |
| EFSI | European Fund for Strategic Investment |
| EFTA | European Free Trade Area |
| EGMI | European Group on Market Infrastructures |
| EIB | European Investment Bank |
| EIOPA | European Insurance and Occupational Pensions Authority |
| ELTIFs | European Long-Term Investment Funds |
| EMDE | Emerging market and developing economies |
| EMIR | European Market Infrastructure Regulation |
| EMTN | Euro Medium-Term Note |
| EMU | Economic and Monetary Union |
| EP | European Parliament |
| ERCC | ICMA European Repo and Collateral Council |
| ESAs | European Supervisory Authorities |
| ESG | Environmental, social and governance |
| ESCB | European System of Central Banks |
| ESFS | European System of Financial Supervision |
| ESM | European Stability Mechanism |
| ESMA | European Securities and Markets Authority |
| ESRB | European Systemic Risk Board |
| ETF | Exchange-traded fund |
| ETP | Electronic trading platform |
| EU27 | European Union minus the UK |
| ESTER | Euro Short-Term Rate |
| ETD | Exchange-traded derivatives |
| EURIBOR | Euro Interbank Offered Rate |
| Eurosystem | ECB and participating national central banks in the euro area |
| FAQ | Frequently Asked Question |
| FASB | Financial Accounting Standards Board |
| FATCA | US Foreign Account Tax Compliance Act |
| FATF | Financial Action Task Force |
| FCA | UK Financial Conduct Authority |
| FEMR | Fair and Effective Markets Review |
| FICC | Fixed income, currency and commodity markets |
| FIIF | ICMA Financial Institution Issuer Forum |
| FMI | Financial market infrastructure |
| FMSB | FICC Markets Standards Board |
| FPC | UK Financial Policy Committee |
| FRN | Floating-rate note |
| FRTB | Fundamental Review of the Trading Book |
| FSB | Financial Stability Board |
| FSC | Financial Services Committee (of the EU) |
| FSOC | Financial Stability Oversight Council (of the US) |
| FTT | Financial Transaction Tax |
| G20 | Group of Twenty |
| GBP | Green Bond Principles |
| GDP | Gross Domestic Product |
| GFMA | Global Financial Markets Association |
| GHOS | Group of Central Bank Governors and Heads of Supervision |
| 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 |
| HMRC | HM Revenue and Customs |
| HMT | HM Treasury |
| HQLA | High Quality Liquid Assets |
| HY | High yield |
| IAIS | International Association of Insurance Supervisors |
| IASB | International Accounting Standards Board |
| IBA | ICE Benchmark Administration |
| ICMA | International Capital Market Association |
| ICSA | International Council of Securities Associations |
| ICSDs | International Central Securities Depositaries |
| IFRS | International Financial Reporting Standards |
| IG | Investment grade |
| IIF | Institute of International Finance |
| IMMFA | International Money Market Funds Association |
| IMF | International Monetary Fund |
| IMFC | International Monetary and Financial Committee |
| 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 fűr Wiederaufbau |
| KID | Key information document |
| KPI | Key performance indicator |
| 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 |
| MAR | Market Abuse Regulation |
| MEP | Member of the European Parliament |
| MiFID | Markets in Financial Instruments Directive |
| MiFID II/R | Revision of MiFID (including MiFIR) |
| MiFIR | Markets in Financial Instruments Regulation |
| MMCG | ECB Money Market Contact Group |
| MMF | Money market fund |
| MOU | Memorandum of Understanding |
| MREL | Minimum requirement for own funds and eligible liabilities |
| MTF | Multilateral Trading Facility |
| NAFMII | National Association of Financial Market Institutional Investors |
| NAV | Net asset value |
| NCA | National competent authority |
| NCB | National central bank |
| NPL | Non-performing loan |
| NSFR | Net Stable Funding Ratio (or Requirement) |
| OAM | Officially Appointed Mechanism |
| OJ | Official Journal of the European Union |
| OMTs | Outright Monetary Transactions |
| ORB | London Stock Exchange Order book for Retail Bonds |
| OTC | Over-the-counter |
| OTF | Organised Trading Facility |
| PCS | Prime Collateralised Securities |
| PMPC | ICMA Primary Market Practices Committee |
| PRA | UK Prudential Regulation Authority |
| PRIIPs | Packaged Retail and Insurance-Based Investment Products |
| PSEs | Public Sector Entities |
| PSI | Private Sector Involvement |
| PSIF | Public Sector Issuer Forum |
| QE | Quantitative easing |
| QIS | Quantitative impact study |
| QMV | Qualified majority voting |
| RFQ | Request for quote |
| RFRs | Near risk-free rates |
| RM | Regulated Market |
| RMB | Chinese renminbi |
| RPC | ICMA Regulatory Policy Committee |
| RSP | Retail structured products |
| RTS | Regulatory Technical Standards |
| RWA | Risk-weighted asset |
| SBBS | Sovereign bond-backed securities |
| SEC | US Securities and Exchange Commission |
| SFT | Securities financing transaction |
| SGP | Stability and Growth Pact |
| SI | Systematic Internaliser |
| SMEs | Small and medium-sized enterprises |
| SMPC | ICMA Secondary Market Practices Committee |
| SMSG | Securities and Markets Stakeholder Group (of ESMA) |
| SARON | Swiss Average Rate Overnight |
| SOFR | Secured Overnight Financing Rate |
| SONIA | Sterling Overnight Index Average |
| SPV | Special purpose vehicle |
| SRF | Single Resolution Fund |
| SRM | Single Resolution Mechanism |
| SRO | Self-regulatory organisation |
| SSAs | Sovereigns, supranationals and agencies |
| SSM | Single Supervisory Mechanism |
| SSR | EU Short Selling Regulation |
| STS | Simple, transparent and standardised |
| T+2 | Trade date plus two business days |
| T2S | TARGET2-Securities |
| TD | EU Transparency Directive |
| TFEU | Treaty on the Functioning of the European Union |
| TLAC | Total Loss-Absorbing Capacity |
| TMA | Trade matching and affirmation |
| TONA | Tokyo Overnight Average rate |
| TRs | Trade repositories |
| UKLA | UK Listing Authority |
| VNAV | Variable net asset value |

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