ICMA

International Capital Market Association

# QUARTERLY REPORT

ASSESSMENT OF MARKET PRACTICE AND REGULATORY POLICY

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**12 April 2019**

Second Quarter. Issue 53. Editor: Paul Richards

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 over 560 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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# ICMA's strategic focus

*By Mandy DeFilippo*

As the Chair of ICMA, I am delighted to provide this quarter's Foreword, during what has proven to be a challenging political period across Europe. With the question of Britain's pending exit from the EU still not resolved as we come to publication, the only thing that seems clear is that we are undoubtedly in the middle of an unparalleled period of political uncertainty across the European landscape. This presents unique challenges for the capital markets across Europe and internationally, and for participants in those markets – and an inimitable backdrop to the relevance of ICMA's work.

Against such a dynamic and, at times, volatile environment, ICMA serves its members by providing a forum for discussion around market standards and regulatory issues faced by market participants, and also by acting as a trusted source of pertinent information. Brexit has provided an exceptional opportunity for the organisation to excel in that role. Since the AGM last May, ICMA has hosted and chaired many calls and meetings for members, posting regular updates to our website. In addition, ICMA has been actively engaged publicly. The Association published an open letter to President Juncker and Prime Minister May regarding the dangers of a "cliff-edge" Brexit, and has attended numerous meetings with regulators, central banks and the European Commission in relation to the potential impact of Brexit on the capital markets.

Although Brexit may be top of the agenda in Europe at the moment, it is by no means the only topic that ICMA has been working on. While the implementation of MiFID II/R in January of 2018 might already feel a distant memory, ICMA made a substantial effort to engage with our membership in Europe and beyond both during and after the implementation date. Feedback post the first year of implementation indicates that MiFID II/R continues to bed in with more ongoing work required to achieve the increase in trade transparency and improved quality of pre/post-trade data that MiFID II/R originally contemplated. And, in relation to LIBOR transition and benchmarks regulation, ICMA is heavily engaged through direct input to numerous working groups in the UK, the EU27 and Switzerland, in what I believe will be one of the most significant challenges to the financial markets globally for many years.

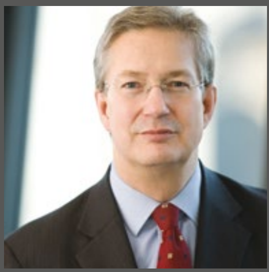
As I said in my address at the AGM last year, regulation and technology, market fragmentation, and sustainable finance continue to be key focuses for our strategy at ICMA. We recognise that distributed ledger technology, artificial intelligence/machine learning and big data analytics have the potential to impact bond markets at every stage of the lifecycle. Board level guidance on ICMA's engagement in this area targets best practice and common standards, encouraging discussion with all involved parties on technological developments, and keeping members informed. Our Primary Market Mapping Directory provides an example of our approach towards what is a rapidly evolving agenda.

ICMA has played a fundamental role in the development of the global market for green bonds and in the broader sustainability space. Now a member of the EU High Level Group on Sustainable Finance, we are also looking at how ICMA should extend its activities to support green and sustainable finance initiatives for our members. The upcoming 2019 Green Bond Principles and Social Bond Principles AGM in Frankfurt on 13 June will further promote this activity and will form part of a "green and sustainable week" in Frankfurt for the finance industry.

In addition to these areas of strategic focus, ICMA runs additional programmes which support our members. The ICMA Future Leaders Forum, designed to reach out to the next generation of leaders in the industry, the ICMA Women's Network, and the ICMA Mentoring Platform are all examples where ICMA provides a key benefit to its members across the full spectrum of professional development. I believe these programmes are unique in the industry, given their geographic scope and participation from all parts of the market. Having attended and, at times, hosted events for both the IWN and the Future Leaders, I believe the quality they offer for our members is outstanding.

All of these issues are on the agenda for discussion at the ICMA AGM and Conference in Stockholm in May. As ever, the meeting should provide an opportunity to share views on the future of the capital markets with peers from the industry across the world, and to frame plans for the coming year. I am looking forward to seeing many of you there.

**Mandy DeFilippo** *is a Managing Director and Global Head of Risk Management for Fixed Income & Commodities, Morgan Stanley International PLC, and Chair of the ICMA Board.*



# Message from the Chief Executive

*By Martin Scheck*

We have been continuing to help members prepare for Brexit in international capital markets, by working with members in our committees, holding conference calls with record levels of participation, updating our website and the FAQs as and when necessary, and monitoring the progress made by the UK and the EU27 (as a whole and at national level) in dealing with specific cliff-edge risks which could cause market disruption when passporting rights between the UK and EU27 cease. Significant progress has been made by the authorities, though risks remain. There is more detail in this Quarterly Report.

A further major topic occupying much of our time is the ongoing international work programme on the replacement of LIBOR. The UK authorities have repeatedly indicated the importance of transitioning away from LIBOR, which could cease to exist after the end of 2021. Progress has been made in the choice of replacement risk-free rates. It is encouraging that new floating rate bonds being issued already reference SONIA in the UK, or SOFR in the US, and that market conventions are developing. This early adoption is particularly welcome since it "caps" the extent of the difficult legacy issues relating to bonds referenced to LIBOR, which mature after its possible disappearance after the end of 2021. As part of our work with the Sterling Risk-Free Rate Bond Sub-Group, which ICMA chairs, we are considering the challenges inherent in changing the terms of a bond issue to reflect the new benchmark and analysing how the risks can be mitigated. None of the potential solutions is straightforward. International coordination between the five main IBOR jurisdictions – the UK, the US, the euro area, Switzerland and Japan – is important, as is coordination between the different market sectors, bonds, loans and derivatives, all of which are affected. We continue to play our part through close collaboration with the authorities, our direct involvement in the Euro Risk-Free Rate Working Group, Switzerland's National Working Group and the Sterling Risk-Free Rate Working Group. We are liaising extensively with other trade associations and we continue to promote awareness of these developments to our members across the globe at all our events and through various media.

Environmental, Social and Governance (ESG) investing continues to become mainstream, driven by a variety of factors including demographic trends, the realisation that climate change is a pressing issue, new technology and developments in renewable energy. Our own work in this area, which has been primarily focused around our careful stewardship of the Green Bond Principles and Social Bond Principles, is increasing and becoming more integrated with what we have become used to considering our "core" bond market workstreams. Recent responses, for example to the ESMA consultations, *Integrating Sustainability Risks and Factors in MiFID II* and *Integrating Sustainability Risks and Factors in the UCITS Directive and AIFMD*, came from our primary market and asset management communities respectively. Through our membership of the European Commission's Technical Expert Group on Sustainable Finance we remain very engaged in the Commission's work to develop a taxonomy to classify environmentally sustainable activities and a green bond standard for Europe; we responded to the consultation on the *Usability of the EU Taxonomy* from the point of view of the Green Bond Principles. More on all these developments elsewhere in this report.

Looking at developments in the wider world beyond Europe, where Brexit is rather less of an issue, we have recently replicated our long-established Primary Market Forum in two locations in Asia bringing together borrowers, syndicate banks and investors to look at regional variations on bond issuing practice in the context of our own recommendations on best practice and regulation in this area. At the Hong Kong event, hosted by HKMA, the debate centred around the increasing amount of issuance by Chinese firms through Hong Kong and the lessons learned in the transition from a domestic to an international issuing space. The Mumbai event, where we partnered with YES Bank, brought in a substantial number of borrowers from the domestic bond markets to hear about trends and opportunities in the international market and the differences between local and international issuing practice. Our successful ICMA Women's Network was also extended to Asia for the first time with a networking event in Hong Kong, featuring inspiring women from the market talking about their own experience of developing capital market careers.

Planning for our 51st AGM is now well advanced: the venues are booked and the agenda, ranging across a full range of topics that concern us all in capital markets, from FinTech developments to geopolitical change, taking in reviews of the post-crisis regulatory environment and the rise of sustainability, is virtually complete. I hope that at least as many of you who came to the 50th AGM in Madrid will be able to join us in Stockholm from 15 to 17 May this year – I look forward to seeing you there.

**Martin Scheck**
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# Brexit in the international capital markets[1]

By Paul Richards

## Summary

Since the UK referendum in June 2016, the British Government has proposed to leave the EU Single Market in financial services when it leaves the EU. Instead of a Single Market, the EU27 and the UK will become two separate markets when passporting rights cease. Market firms are in a better position to avoid cliff-edge risks arising from market fragmentation if they are authorised to operate in both the EU27 and the UK. But that still leaves cliff-edge risks *between* EU27 and UK markets when passporting rights cease. Although significant progress has been made by the EU27 and UK authorities to address them, risks remain. A key issue for trade negotiations after Brexit is what role regulatory equivalence will play between EU27 and UK capital markets in future.

## The political background

1 The British Government reached agreement with the EU27 at the European Council on 25 November on a Withdrawal Treaty and on a Political Declaration on Future Relations. This agreement is subject to ratification by both the British Parliament and the European Parliament. If the agreement was not ratified by both the British Parliament and the European Parliament and the necessary legislation was not enacted before Article 50[2] was due to expire on 29 March, the default position was for the UK to leave the EU on 29 March without an agreement (ie a no-deal Brexit), unless Article 50 was extended (by the EU by unanimity) or revoked (by a unilateral decision by the British Government).

2 The agreement between the British Government and the EU27 was rejected by the House of Commons in separate votes on 15 January and 12 March by large majorities. On 13 March, the House of Commons voted against a no-deal Brexit, though the vote was not binding; and on 14 March, the House of Commons voted in favour of delaying Brexit beyond 29 March by extending Article 50. On 20 March, the Prime Minister proposed to the EU27 a "short, limited" extension of Article 50 until 30 June.

3 At its meeting on 21 March, the European Council decided unanimously:

- to extend Article 50 until 22 May, subject to approval of the Withdrawal Agreement by the House of Commons by 29 March, though the Withdrawal Agreement (without the Political Declaration) was subsequently rejected by the House of Commons again on 29 March;
- if the Withdrawal Agreement was not approved by 12 April, the UK should indicate a way forward before 12 April for consideration by the European Council.

4 On 2 April, following a Cabinet meeting, the Prime Minister proposed a cross-party approach to a Brexit deal in an attempt to win the approval of the House of Commons and, on 5 April, she proposed to the EU27 a further extension of Article 50 beyond 12 April until 30 June at the latest. She agreed that the UK should prepare for elections to the European Parliament on 23 May, in case the agreement is not ratified by the House of Commons before then. The European Council met on 10 April to consider the Prime Minister's request and agreed unanimously on an extension of Article 50 until 31 October, while allowing the UK to leave the EU earlier if the agreement is ratified earlier.[3] There will be a review of progress at the European Council in June.

1. For official and other sources of information on Brexit in the international capital markets, see the ICMA Brexit webpage on the ICMA website.

2. On 29 March 2017, the UK notified the European Council of its intention to withdraw from the EU in accordance with Article 50 of the Treaty of European Union (TEU). According to Article 50(3) TEU, the Treaties cease to apply two years after the notification, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period.

3. If the UK is still an EU Member State on 23-26 May, it will be under a legal obligation to hold elections to the European Parliament. If it does not do so, the UK will leave the EU on 1 June without an agreement.

5 Following the European Council meeting on 10 April, this assessment considers the risks arising from Brexit for ICMA member firms involved in the international capital markets in the UK and the EU27. It does not consider the exchange rate, monetary or economic policy implications.

## The legal background

6 If and when it *is* ratified, the EU27/UK Withdrawal Agreement is legally binding. The Political Declaration which accompanies the Withdrawal Agreement is not legally binding. It is intended to lay the groundwork for future negotiations during the transition period after Brexit, but covers financial services only briefly, and at a high level of generality. The transition (or "implementation") period is due to last from Brexit until the end of 2020, though it could be extended beyond the end of 2020 once for up to one or two further years, if both sides agree.[4] During the transition period, the UK would effectively be subject to EU rules, including new EU rules, without any say in making them.

### The legal consequences of Brexit in the UK[5]

In the UK, the European Union (Withdrawal) Act 2018 was passed in June 2018. It assumes the UK's exit from the EU on 29 March 2019 without a deal and would need to be amended if a deal is agreed or the Article 50 period is extended. The Withdrawal Act will ensure that most EU-derived laws and regulations will continue to apply in the UK, but as domestic UK law, outside the jurisdiction of the EU.

The Withdrawal Act also gives the British Government powers to make regulations by statutory instrument (SI) to amend "deficiencies" in retained EU law, so that legislation works appropriately once the UK has left the EU. Using powers under the Withdrawal Act, the British Government plans to pass up to 600 SIs to amend retained EU law by the exit date.

Alongside changes to the law, relevant regulators, such as the FCA and PRA, are having to make corresponding changes to their rules and processes.

If a Withdrawal Agreement is reached between the UK and the EU27, the British Government will need to secure the passage of a Withdrawal Agreement Implementation Bill to enable the Withdrawal Agreement to be ratified.

## The implications of the UK proposal to leave the EU Single Market

7 Since the UK referendum in June 2016, the British Government has proposed to leave the EU Single Market in financial services when it leaves the EU. Instead of a Single Market, the EU27 and the UK will become two separate markets when passporting rights between the EU27 and the UK cease. The European Commission has stated that, when passporting rights cease, "there will be no Single Market access". When passporting rights cease, cliff-edge risks will arise as a result of fragmentation between the EU27 and UK markets: on Brexit, if the UK leaves the EU without an agreement; or at the end of the transition period after Brexit, even if there is an agreement. The key difference is that, if there is a transition period after Brexit, that will give market firms more time to prepare. In preparing for Brexit, our focus at ICMA has been on ensuring that cliff-edge risks in international capital markets are addressed and avoided.

## The case for market firms to be authorised in both the EU27 and the UK

8 To reduce cliff-edge risks when passporting rights cease, many market firms have chosen to be authorised to provide financial services in both the EU27 and in the UK. The ECB, EBA and ESMA have all drawn attention to the need for market firms to be authorised to operate in the EU27 when passporting rights cease. In the case of the ECB:

- it usually takes six months for a decision once an application is complete;
- banks need to be capable of managing all material risks independently and at the local level;
- sufficient staff need to be located locally, including risk management and front office staff;
- part of the risk on "back-to-back booking models" should be managed and controlled locally.

9 Market firms are in a better position to avoid cliff-edge risks if they are authorised to operate in both the EU27 and the UK. In some cases, this involves significant one-off costs: eg in transferring staff, offices, technology, capital and financial assets from London to one or more locations in the EU27; and extra running costs from operating in two separate markets in the EU27 and the UK rather than in one Single EU Market. These costs reduce the competitiveness of European capital markets in global terms. And for market firms, the migration of

4. It is not yet clear whether the dates in the Withdrawal Agreement will be amended as a result of the delay in Brexit following the extension of Article 50.

5. Source: Linklaters: *Are the UK and EU Ready for Brexit?* 14 February 2019.

businesses, assets and contracts in a short period of time poses operational risks. In general, large sell-side and buy-side firms seem better prepared than smaller firms, and financial institutions seem better prepared than some of their clients.

## The need to address cliff-edge risks in international capital markets

10 When passporting rights cease, it appears that market firms will in general be able to carry out contractual obligations already agreed between EU27 and UK entities on cross-border financial contracts.[6] But when passporting rights cease, specific cliff-edge risks will arise. The question is whether these specific cliff-edge risks can be addressed and avoided.

11 In the UK, a Temporary Permissions Regime will be introduced for a limited period in the event of a no-deal Brexit. This will allow inbound firms and funds to continue operating in the UK on the basis of their current permissions for a limited period while seeking full UK authorisation. On 28 February, the Bank of England announced that, in the event of a no-deal Brexit, it will grant transitional relief for UK regulated firms for a period of 15 months after Brexit. This means that, subject to limited exceptions, UK regulated firms do not generally need to take action now to implement changes in UK law arising from a no-deal Brexit. The Bank of England's approach is in line with the approach taken by the UK FCA.

12 But at EU27 level, there has so far been no equivalent to the Temporary Permissions Regime. Instead, the European Commission has concluded that only a limited number of contingency measures is necessary to safeguard financial stability in the EU27, and only where preparations by market firms are clearly insufficient to address these risks by the withdrawal date.

13 In addition to legal provisions at EU27 level, it is important to take account of legal provisions at national level, where national governments in the EU27 have introduced legislation in an attempt to minimise disruption arising from a no-deal Brexit. A number of EU Member States have put arrangements in place similar but not identical to the arrangements for the UK Temporary Permissions Regime, including Germany, Spain, France, Ireland, Italy, Luxembourg and the Netherlands.[7]

## Progress in addressing specific cliff-edge risks[8]

The authorities in the EU27 and the UK have recently made significant progress in addressing some of the specific cliff-edge risks which would arise in international capital markets, in the event of a no-deal Brexit, in order to prevent financial instability. It is important to note that the specific cliff-edge risks for which temporary equivalence and recognition would be granted in the event of a no-deal Brexit will run out quickly, unless they can be renewed. If there *is* an EU27/UK Withdrawal Agreement, there may still be cliff-edge risks at the end of the transition period.

### *CCPs and CSD*

First, cross-border central clearing of derivatives is one area where both the EU27 and the UK agree that financial stability risks may arise.

On 19 December, the European Commission adopted a temporary and conditional equivalence decision for 12 months after a no-deal Brexit to ensure that there will be no disruption in central clearing of derivatives.

On 4 February, ESMA agreed an MOU with the Bank of England for temporary recognition of CCPs currently established in the UK so that they can continue providing services in the EU27, and on 18 February ESMA formally recognised UK CCPs as equivalent. Similar arrangements have been made for the UK CSD for two years, taking account of its role in servicing Irish securities, so as to reduce the risk of disruption to the Irish securities market.

On 25 February, the UK and US authorities made a joint statement on continuity of derivatives trading and clearing activities between the UK and the US after Brexit; and on 5 March, the Bank of England and ECB announced a new swap line as a precaution against financial instability.

6. Nausicaa Delfas, Executive Director of International, FCA: "While some Member States are taking action, and firms are taking their own action, there are likely to be some remaining areas where the legal risks relating to the ongoing services of existing customers have not been fully mitigated.": speech on *Brexit and Beyond* in London on 21 March 2019.

7. Nausicaa Delfas, Executive Director of International, FCA: speech on *Brexit and Beyond* in London on 21 March 2019.

8. For more detail, see the Bank of England Financial Policy Committee Summary and Record, published on 5 March 2019. See also the Brexit webpage on the ICMA website and the sections in this Quarterly Report on: ESMA guidance in relation to MiFID II/R in the first quarter of 2019; credit rating agencies; and OTC (derivatives) regulatory developments.

### *Uncleared OTC derivatives*

Second, the Bank of England has been concerned that, in the absence of action, certain lifecycle events will not be able to be performed on uncleared OTC derivative contracts across borders between counterparties in the EU27 and the UK, in the event of a no-deal Brexit.

On 19 December, the European Commission adopted delegated regulations allowing some OTC derivative contracts to be transferred to an EU counterparty during a fixed period after a no-deal Brexit.

On 13 March, following proposals from ESMA, EBA and EIOPA, Commission delegated regulations entered into force allowing UK counterparties to be replaced with EU counterparties without triggering the clearing obligation; and facilitating the novation of legacy contracts to EU counterparties, since novation might also trigger the application of bilateral margin requirements.[9]

However, market firms still face some uncertainties in the EU27 at national level, and the time needed for contracts to be transferred is considerable, as clients are frequently slow to agree to transfer.

### *Supervision and enforcement*

Third, ESMA, national securities regulators in the EEA and the FCA announced on 1 February that they have agreed an MOU to allow information exchange for effective supervision and enforcement, and continued access to UK CCPs and the UK CSD, in the event of a no-deal Brexit. ESMA and the FCA have also agreed an MOU on the exchange of information for the supervision of CRAs and TRs; and MOUs have been agreed with EBA and EIOPA too. These MOUs would be due to come into effect immediately after the UK became a third country, in the event of a no-deal Brexit.

### *Delegation of fund management*

Fourth, EU rules allow asset managers to delegate fund management outside the EU27 when a cooperation agreement is in place between the authorities concerned. Provision for the continuation of the delegation model is contained in the MOU between ESMA, national competent authorities in the EU27 and the FCA announced on 1 February.

### *Other issues*

Finally, there are a number of other cliff-edge risks relating to the impact of Brexit on international capital markets that still need to be addressed. Clearly, there should be more time to address them, if there is an agreement between the EU27 and the UK on withdrawal leading to a transition period or a further extension of Article 50. Examples include:

*Personal data:* Although the MOUs between the EU27 and the UK cover information exchange for supervision and enforcement, there are still outstanding questions about the free flow of personal data from the EU to the UK after a no-deal Brexit, which may restrict the access of EU27 customers to UK financial service providers.

*Trading venues:* There is currently no provision for the recognition of the equivalence of UK trading venues by the EU27. EU customers may not be able to trade certain securities on UK trading venues, in the event of a no-deal Brexit.

*Non-EU exposures:* The Bank of England has noted that EU regulations impose higher capital and liquidity requirements on EU banks' and insurance companies' non-EU exposures and also impose some restrictions on holdings of non-EU assets.

*Transparency:* The MiFID II transparency framework is based on thresholds specified by ESMA. These thresholds, which currently include both the EU27 and the UK, will need to be adjusted after Brexit. This will take time to resolve.

9. See also ESMA: *Update on the UK's Withdrawal from the EU – Preparations for a Possible No-deal Brexit Scenario on 12 April*: 28 March 2019. This notes that references to a no-deal Brexit on 29 March need to be updated to 12 April.

## International capital markets in the EU27 after Brexit

14 When passporting rights cease, either on Brexit or at the end of the transition period after Brexit, the EU27 and the UK will have two separate – though interconnected – capital markets. Europe's biggest capital market will be outside the EU.

15 For the EU27, it will be important to complete Capital Markets Union, if the EU27 wants to diversify funding and investment opportunities across its national borders. It will also be important for the EU27 to clarify the relationship between the euro area and the rest of the EU27. Such a clarification was provisionally agreed by a former British Government with the EU27 in early 2016 but subsequently abandoned following the outcome of the UK referendum in June 2016.

16 Supervisory convergence within the EU27 will be needed to avoid regulatory arbitrage between different national jurisdictions in the EU27 (eg on relocation decisions to the EU27 by market firms in the UK). In ESMA's view, financial centres in the EU27 should be free to compete with each other in offering speed and efficiency to relocating firms, but in all cases the EU rulebook should be consistently applied and supervised.

17 In anticipation of Brexit, a number of market firms in the UK have been moving EU27 activities from one location (ie London) to a range of different locations within the EU27 (eg Frankfurt, Paris, Amsterdam, Luxembourg and Dublin), all with different national regulators. In ESMA's view, this increases the need for powers to ensure consistency and convergence between national regulators within the EU27.

## Market access between the EU27 and the UK after Brexit

18 If the UK leaves the EU with a Withdrawal Agreement, it is not yet clear what form a future trade agreement between the EU27 and the UK after the end of the transition period will take, as the Political Declaration sets out a range of potential options; and it is not clear whether it will be possible to complete the negotiations within the transition period. (The free trade agreement between the EU and Canada took seven years to negotiate and ratify.) The future prospect will be even more uncertain if the UK leaves the EU *without* an agreement.

19 The Political Declaration by the EU27 and the UK covers financial services only briefly, and at a high level of generality. But the focus is on regulatory equivalence between the EU27 and the UK:

> "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 from the Union, endeavouring to conclude these assessments before the end of June 2020. The Parties will keep their respective equivalence frameworks under review."[10]

20 When passporting rights between the EU27 and the UK cease, the UK will become a third country. The British Government has indicated that it does not intend to be a "rule-taker". Consequently, when it becomes a third country, the UK's approach to regulation may *diverge* from the EU27, though the extent to which this can happen in practice, particularly in wholesale markets, is likely to be limited by global agreement under the G20, in which both the EU27 and UK participate. But where regulatory *convergence* between the EU27 and the UK continues, and provision is made for regulatory equivalence between the EU27 and the UK, market firms operating across borders between the EU27 and the UK will be able to make use of this.

## Regulatory equivalence between the EU27 and the UK after Brexit

21 EU regulatory equivalence with third countries is currently a patchwork:

- It applies to some parts of the EU regulatory framework, but not others.
- It requires a judgment by the European Commission, and this takes time to assess.
- The determination of equivalence can be withdrawn at short notice.
- The assessment is based on measuring outcomes, which are difficult to assess.
- The determination is made unilaterally by the EU.

22 When passporting rights cease, the EU27 and the UK will start with identical rules and close supervisory cooperation. The UK is planning to develop a new partnership with the EU27, under which it can:

- qualify for all the provisions relating to regulatory equivalence already granted to other third countries; and
- negotiate enhancements during the trade negotiations after Brexit. There is potential provision for negotiating enhancements by June 2020 in the Political Declaration. Amendments to the MOUs between the EU27 and the UK may also be needed.

23 It is also important to note that, where equivalence is granted to provide an EU-wide passport to firms in the UK, ESMA considers that it needs appropriate safeguards giving the EU stronger powers to regulate and monitor third country investment firms in wholesale markets.

10. Political Declaration Setting out the Framework for the Future Relationship Between the EU and the UK, paragraph 38: 25 November 2018.

## Brexit: ICMA's role and approach

ICMA's role is to encourage efficient and integrated capital markets, which are necessary to support economic growth.

ICMA's approach has been to focus on the potential impact of Brexit on international capital markets, particularly the need to address and avoid cliff-edge risks which arise when passporting rights between the EU27 and the UK cease.

ICMA is not lobbying for any particular financial centre. ICMA's members are based in London, the EU27 and more broadly.

ICMA has been discussing capital market preparations for Brexit with members through its main ICMA Market Practice and Regulatory Policy Committees and reporting to the ICMA Board.

ICMA is keeping in contact with the authorities in the UK, the EU27 and the euro area.

ICMA is cooperating with other trade associations by sharing information, wherever possible.

ICMA is keeping members up-to-date on Brexit by giving them regular assessments through the ICMA Quarterly Report and conference calls.

ICMA has posted on its website for members an ICMA Brexit FAQ, focusing on ICMA's own documentation.

ICMA is keeping its Brexit webpage up-to-date, both with its own work, and also with electronic links to key documents published by the authorities in the EU27 and the UK, and with links to the webpages of law firms and others.

## Conclusions

24 Under current British Government policy to leave the EU Single Market when it leaves the EU, the EU Single Market will become two separate markets when passporting rights cease. If the UK leaves the EU without an agreement, passporting rights will cease on Brexit. If there *is* an agreement, passporting rights will only cease at the end of the transition period after Brexit. This will give market firms more time to prepare.

25 When passporting rights cease, cliff-edge risks will arise as a result of fragmentation in international capital markets between the EU27 and the UK. Market firms are in a better position to avoid cliff-edge risks if they are authorised to operate in both the EU27 and UK markets, though operating in two separate markets instead of a Single Market involves costs: both set-up costs and extra running costs.

26 But that still leaves cliff-edge risks *between* the EU27 and the UK when passporting rights cease. In the event of a no-deal Brexit, the UK is proposing to address these risks through a Temporary Permissions Regime for EU27 firms. There is no equivalent in the EU27. Instead, cliff-edge risks between the EU27 and the UK are being addressed case by case in order to reduce market uncertainty and prevent financial instability.

27 Although significant progress has been made on addressing cliff-edge risks, there are still some unresolved issues, and it is not clear whether there are gaps. The assessment of the Bank of England Financial Policy Committee, published on 5 March, is that, in the event of a no-deal Brexit, "some disruption to cross-border services is possible and, in the absence of other actions by EU authorities, some potential risks to financial stability remain".[11]

28 Even if there is an agreement between the EU27 and the UK, there is as yet no detail about how EU27 and UK capital markets will interconnect in future, once passporting rights cease, as the Political Declaration on future trade relations deals with financial services only briefly and at a high level of generality:

(i) One option is for the regulation of the two separate markets to diverge. When the UK becomes a third country, it will not want to be a "rule-taker". Brexit will provide the opportunity for divergence to occur once passporting rights cease.

(ii) But in the period up to June 2020, the Political Declaration will also provide an opportunity for the UK to negotiate regulatory equivalence with the EU27 as a third country. Both sides accept that regulatory equivalence is currently a patchwork. There may be scope to negotiate enhancements.

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11. Bank of England Financial Policy Committee Summary, published on 5 March 2019.

# Trading in fragmented capital markets

*By Robert Ophèle*

Thanks to ICMA for holding its Secondary Market Forum in Paris and thank you for giving me the opportunity to share with you some thoughts about probably one of the hottest issues of the year, namely market fragmentation.

First, the FSB. The 2019 Japanese Presidency of the G20 identified market fragmentation as a major concern and we are expecting an FSB report complemented by an IOSCO report identifying inappropriate signs of fragmentation and proposing tools to address them. The bond market is not directly identified as a major source of fragmentation but fragmentation in OTC derivative markets, which are so closely linked with the bond market, are clearly under review.

Second, the Brexit. It is obviously a huge catalyst for increasing the fragmentation since, by leaving the EU, the UK is putting an end to the freedom of establishment and to the freedom to provide services between the UK and the EU27. Obviously the EU will no longer be in a position to rely on the pool of liquidity managed in London and part of it should relocate in the EU.

And third, the EU itself. To be fair, even inside the EU, we have not yet dismantled all the barriers that fragment our capital markets. The European Post Trade Forum – the EPTF – has updated in its 2017 report the list of remaining barriers and we should recognize that issuance, trading, clearing, settlement and asset servicing of a security are still different depending of the location of issuers and investors in the EU. If we really want to achieve a Capital Markets Union, the next European mandate will have to deliver tangible progress.

I will try to advocate for a reasonable, smart fragmentation at international level and for a vigorous push in favour of a defragmentation at EU level, treating the UK as a third country since such is their decision.

One could argue that, after having collectively designed at international level a fair amount of financial regulations that are now implemented fairly extensively by all major jurisdictions, it could be time to dismantle the many remaining barriers to cross-border financial services and develop an open system based on mutual recognition and deference to third country regulators. Obviously the UK and the EU27, having at this juncture before Brexit the very same rulebook, are perfect candidates for implementing such a policy.

It would foster economic efficiency since capital markets are more efficient when they are working globally without any barriers which are detrimental to the depth and quality of their liquidity, which prevent savings in collateral encumbrance, which reduce efficiency in hedging strategies. …. And finally it would make your life easier.

But fragmentation should not be demonized.

First, it is legitimate for any large jurisdiction to avoid depending on third countries or on offshore financial centres for the management of its savings, for the arrangement of its funding and for supporting the development of its corporates abroad. Some fragmentation is also an inevitable consequence of the limits to the extraterritoriality of national rules when full deference to third-country regulators is impossible for core, systemic, strategic financial services. Finally fragmentation, if managed properly, also has a positive impact on financial stability, reducing the transmission of economic shocks, increasing the resilience of both domestic and global financial markets and supporting risk diversification.

These three dimensions are illustrated in one of the recitals of an equivalence decision already taken some years ago by the EU Commission in favour of US trading venues: such a decision should (I quote) "be read in the light of the objectives pursued by these acts, in particular their contribution to the establishment and functioning of the internal market, market integrity, investor protection and ultimately, but no less importantly, financial stability." I take this example because it features prominently in an equivalence decision, meaning that these concerns are not systematically leading to fragmentation.

Actually, fragmentation is not justified when there is no significant risk for the functioning of the domestic market, no significant risk for market integrity, no significant risk for investor protection or no significant risk for financial stability. But in cases when market fragmentation is justified, regulators should alleviate their consequences for the industry.

At a minimum, when imposing some form of location policy, one should try to reduce the administrative burden of multiple, overlapping and sometimes inconsistent reporting and above all to avoid contradictory requirements to financial institutions developing their activity in several jurisdictions. The situation of branches of third country institutions provides an acid test to such an inadequate fragmentation since a branch is bound to comply with the requirements of both the home and host countries; and in some cases it is just impossible. The perimeter of the share trading obligation in case of no-deal Brexit could provide an interesting example of a conflict between overlapping rules. The statement published by ESMA on 19 March on this issue does not appear to lead to a "win-win" situation. Indeed if the UK adopts a reciprocal approach, after a no-deal Brexit, in many cases, maybe as many as around seven hundred cases, the same share could be covered both by a trading obligation in the EU as requested by the EU regulator and in the UK as requested by the UK regulator. This is very unfortunate for EU27 branches of UK firms and for UK branches of EU27 firms; it is even more unfortunate for the efficiency of our markets. You understand that I remain supportive of maintaining a dialogue with UK authorities in order to reach a solution that is workable for both sides and prevents conflicts of rules.

But it is clear that our first target in the EU should be to dismantle all the remaining barriers that fragment our own capital markets. It would be totally inadequate and counterproductive to open further our capital markets before having achieved our own Capital Markets Union. In that perspective, I will elaborate on two different issues of relevance for debt markets. First the issue of the debt distribution process which needs to be further harmonized and enhanced in the EU and, second, the challenge of developing a non-fragmented green bond market.

T2S has been instrumental in overcoming many of the so-called Giovannini barriers and has been a decisive step towards the CMU. But after a couple of years, the weakness of cross-CSD settlements in T2S demonstrates that T2S alone will not deliver the single market for securities Europe needs. It questions the adequacy of the structure of CSDs in Europe with more than thirty CSDs, difficulties to passport CSD services and to overcome a national licence, and finally a key role of single issuer CSDs. The fragmentation of the EU CSD landscape is in strong contrast with the concentrated landscape in the US.

It is a challenge for the equity market, but corporate events are always difficult to handle in a harmonized way; it is also a challenge for the bond market with far less legitimacy. The nominal outstanding amount of bonds issued by euro area residents is actually fairly stable since 2011 but with a decrease in bonds issued by financial institutions and an increase in bonds issued by governments and corporates. In parallel, issuances by European public institutions have also increased. With the raise of the share of non-financial institution issuances, the deficiencies of the current market structure have become more evident. There is now a need clearly expressed by some issuers – see for example the ESM and I have in mind a speech by Klaus Regling last November – and by part of the industry to give debt issuers the possibility to reach effectively their investors EU-wide via an enhanced issuance and distribution channel; it is probably time to carefully review different options in order to overcome the current fragmentation.

The green bond market is still in its infancy and after a rapid expansion we seem to have reached a plateau. Green bonds are a very welcome innovation, financing investments needed to fight global warming and reconciling Finance with the People. We need green bonds to resume their development and, in order to achieve that, we need to develop a common European approach that will make investors comfortable with the green nature of their investment without putting too high a reporting cost on the shoulders of the issuers. I know that ICMA is very much involved in this harmonization process with its "Green Bond Principles".

In its Action Plan on sustainable finance published in March 2018, the Commission considered two specific actions to foster the growth of the green bond market. On the one hand, the Commission indicated that the Commission's Technical Expert Group (TEG) on sustainable finance would be responsible for preparing a report on an EU green bond standard, building on existing best practices (Q2 2019). On the other hand, the Commission announced that it would specify the content of the prospectus for green bond issuances to provide potential investors with additional information (by Q2 2019). The AMF considers that a "full" prospectus on green bonds would not be the most appropriate policy response, as this would be burdensome for issuers and could endanger the nascent green bond market, by making those issuances too costly compared to "traditional bonds".

However, investors should at least get access to sufficient and reliable information on the "use of proceeds" by an issuer raising capital through green bonds. An adequate solution would therefore consist in bringing targeted amendments to the Level 2 of the Prospectus Regulation to require additional minimum information in the "use of proceeds" section of a prospectus in case the bond issuance holds itself out as "green". Under that solution, the issuer will still be free to qualify its bond as "green", "social" or "sustainable". However, once a bond has been qualified as such, the issuer would be required to provide additional information, by indicating how the proceeds are used to finance or re-finance, in part or in full, new or existing green/social/sustainable assets or projects. This prospectus "building block" would foster transparency in the green bond market, by centralizing the information on such issuances within the prospectus rather than outside.

To sum up and conclude, I advocate for keeping fragmentation of capital markets at the international level to a minimum and, when needed, alleviating the administrative burden for the industry. But we can only be successful in that respect in Europe providing we suppress the fragmentation of our own capital markets that still handicaps the EU. To achieve that, we should at the same time address the legacy of our patchwork of national markets and the future of our markets for which green bonds are key.

**Robert Ophèle** *is President of the Autorité des Marchés Financiers (AMF). He gave this keynote speech at the ICMA Secondary Market Forum in Paris on 20 March.*

# The ICMA Secondary Market Practices Committee: the past three years

*By Sonali Das Theisen*

## Introduction

When I was asked to become Co-Chair of the ICMA Secondary Market Practices Committee (SMPC) in early 2016, the Committee was already beginning to go through some exciting changes. My predecessor, Asif Godall, formerly of HSBC, had recognized the need to revitalize the SMPC in wake of changing bond market dynamics. Traditionally it had been a sell-side forum focused mainly on best practice in the cross-border investment grade corporate bond markets. Before Asif's departure, he had taken the initiative to broaden the composition of SMPC membership to include the buy side, as well as expand its scope to cover a wider range of topics driving market structure.

I therefore took on my SMPC responsibilities at an inflection point for the organization. In the past three years, it has been gratifying to expand our membership to include many more buy-side firms, as well as to include other market participants such as trading platforms in some of our working groups. As a result of these changes, I believe that during my tenure the SMPC has been a powerful voice in the industry, as it has been able to reflect a broad range of perspectives on secondary market developments.

## Bond market liquidity

ICMA had already put corporate bond market liquidity at the centre of the SMPC's agenda with its inaugural 2014 paper, *The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market*. The follow-up paper published in 2016, *Remaking the Corporate Bond Market*, took the liquidity discussion into the realm of regulators and policy makers, and was instrumental in the European Commission's decision to form an Expert Group on Corporate Bond Markets as part of its broader Capital Markets Union initiative. It was a great to see ICMA invited by the Commission to join the Group, and contribute to its final output and recommendations.

Since then, ICMA has continued its work to raise awareness and stimulate debate around liquidity, with subsequent papers on the state of the credit repo market and the corporate single-name CDS market. At my last meeting of the SMPC, we began to explore the direction of ICMA's projected third study into the ongoing evolution of the European corporate bond secondary market.

## Monetary policy

In 2017, the SMPC was quick to respond to the announcement of the ECB's expansion of its Asset Purchase Programme to include IG corporate bonds. Immediately following the news, the ECB was invited to join a meeting of the SMPC where they could discuss details of the Corporate Sector Purchase Programme, as well as listen to the concerns of ICMA's sell-side and buy-side members. Since the launch of the CSPP, the SMPC has closely monitored impacts on both the secondary and repo markets and has invited the ECB back on two further occasions. These proved to be great opportunities for direct engagement and feedback between the ECB and market participants.

## Electronification

While European bond markets have embraced electronic trading for some time, in recent years both regulation and organic growth have spurred innovation at an unprecedented pace. As Head of Fixed Income Market Structure at Bank of America Merrill Lynch, ensuring that the SMPC promotes responsible electronic evolution has always been high on my list of priorities as Co-Chair. The creation of ICMA's Electronic Trading Council was yet another market-leading response by the SMPC, as it created a forum not only for sell-side and buy-side market structure experts and traders, but also for trading venues and technology providers to discuss the key regulatory, technical and market practice issues in the rapidly evolving structure of the international bond markets.

## MiFID II/R

My tenure as Co-Chair overlapped with the consultation and implementation of MiFID II/R, perhaps the most impactful change in memory to the European bond markets. Here again, the SMPC's MiFID II/R Working Group played an instrumental role–initially in responding to consultations and driving advocacy on key regulatory aspects such as the transparency framework; and then later to assist members in their preparations for January 2018 implementation. Since then, ICMA has remained actively involved in monitoring post-implementation challenges, and is currently working with members and ESMA on a number of issues, including improving the quality of post-trade data.

## Other regulations

Beyond MiFID II/R, the SMPC has remained actively attuned to other regulatory initiatives that have potential significant impacts for the functioning and efficiency of bond markets, such as the implications of FRTB for the capital costs associated with market-making.

ICMA has taken an industry lead on the CSDR mandatory buy-in regime. Following its surprise inclusion in the final Level 1 Regulation, the SMPC was quick to flag the potential for disruptive consequences for bond market liquidity and stability. While implementation has been delayed rather than abandoned, ICMA has worked closely with ESMA in the finalization of the Level 2 technical standards. The SMPC's CSDR Settlement Discipline Working Group is actively working to mitigate any potential adverse consequences by means of implementing the regulatory requirements through the ICMA Secondary Market Rules and Recommendations.

## Expanding into Asian markets

While traditionally the SMPC has been focused on Europe, we have seen an opportunity to adapt the SMPC's work and experience to the benefit of members operating in other global cross-border markets, in particular in the Asia-Pacific region. In 2018 ICMA published a report on the state and evolution of the cross-border APAC secondary corporate bond market. In 2019, the SMPC is planning to explore developments in the internationalization of the Chinese corporate bond secondary market, as well as continue to identify the key extraterritorial impacts of European regulation for the region.

## Looking forward

While I wistfully complete my incredibly rewarding three-year term as SMPC Co-Chair, I do so knowing that it is left in great hands. With Yann Couellan of BNP Paribas Asset Management and David Camara of Goldman Sachs guiding the direction, and with our supremely capable and dedicated secretariat led by Andy Hill in support, I believe the SMPC is poised to be more impactful than ever. As the global cross-border bond markets will no doubt face a raft of challenges and opportunities in the years ahead, the SMPC will continue to be an important force for responsible evolution. I look forward to remaining involved in its important and market-leading work.

**Sonali Das Theisen** *is Head of Fixed Income Market Structure at Bank of America Merrill Lynch, and former Chair of the ICMA Secondary Market Practices Committee.*

# The search for a euro safe asset

By Andy Hill

## Introduction

The idea of a public "safe asset" for the euro area is as old as the currency itself and was seen by some as a necessary, but missing, step in the process of monetary, banking, and capital markets union. The notion regained attention more recently in the wake of the euro sovereign crises, where a safe asset could not only provide emergency funding for stressed euro member economies but would also help to break the "doom loop" of the sovereign-bank nexus (*Brunnermeier et al., 2016*). More recently the discourse has begun to focus on the increasing demand for high-quality liquid assets in a more collateralised financial system. From a central bank perspective, the potential for a safe asset is seen as helping to make the euro a more investable currency while also facilitating the execution of monetary policy.

## What makes an asset safe?

There has been much discussion around what should be the defining characteristics of a safe asset. The starting point is perhaps to distinguish safe assets from the broader class of high-quality liquid assets (HQLA). Generally it is held that a safe asset should not only be of the highest perceived credit quality, be deeply liquid, and have benchmark status (providing for a yield curve), but that it should be counter-cyclical in the sense that it should increase in value in stressed market conditions; importantly this should be due to a perception of quality and safety, rather than as a result of scarcity. Other features considered essential include the capacity to create a deep, liquid derivatives market, the best treatment under regulatory capital and liquidity requirements, as well as central bank eligibility with the lowest possible haircuts. To ensure enough liquidity, who holds and trades the asset is another important consideration, and it would seem desirable that it should provide short-term relative value opportunities for hedge funds as much as long-term investment appeal to buy-to-holds. The US treasury market provides the archetypal safe asset. In the euro area, German government bonds currently serve the role; but this is a relatively limited pool of assets and one that is set to become even smaller.

## Designing a safe asset

While there may be broad agreement on the need for and desired characteristics of a euro safe asset, creating one is a lot more challenging. The first hurdle is that the possibility of a common, jointly guaranteed "eurobond" market has been roundly rejected on the grounds that this would reduce the incentive for "weak" economies to undertake necessary structural reforms and would undermine the stability and fiscal credibility of the euro area (*Issing, 2009*). Other considerations include not increasing the overall issuance stock of euro area sovereign debt and ensuring that there is not a detrimental shift in relative demand away from some domestic markets. Despite these potential limitations, a number of possible solutions have been put forward that continue to engage academics, policy makers, and regulators, as well as market participants. These various proposals can be grouped into four main approaches (*Leandro and Zettelmeyer, 2018*): tranching and pooling existing sovereign debt; pooling with preferred intermediary creditor status ("E-bonds"); pooling of existing sovereign debt, followed by tranching ("ESBies"); and issuance backed by a euro area budget (supranational issuance).

## Tranching and pooling

The proposal here is that sovereign issuers could issue bonds in the form of senior and junior tranches. The senior tranches of euro area government bonds could then be purchased and pooled by an intermediary (or intermediaries) who in turn issues tradable securities with joint and several liability of the underlying sovereign issuers. This idea has been presented most visibly as the "blue bond proposal" (*Delpla and von Weizsäcker, 2010*), where the senior sovereign tranches are identified as "blue bonds" and the junior tranches as "red bonds". The critical consideration here is selecting the appropriate "subordination level". Proponents have suggested that blue bond status should apply to debt up to 60% of national GDP. The thinking is that the relative expensiveness of effectively subordinated national "red bond" issuance should provide an incentive for fiscal discipline. A variant on this theme is the "purple bond proposal", whereby sovereign issuers are incentivised to transition from existing national debt levels (which would be protected from restructuring) to achieving their 60% Fiscal Compact requirements over a 20 year period (gradually transitioning their outstanding stock of protected "purple bonds" to joint and several liability "blue bonds" and subordinated "red bonds").

## E-bonds

The second approach also involves an intermediary absorbing and pooling sovereign issuance (either in the form of purchasing bonds in the secondary market or by buying bonds directly from national issuers) but without any tranching of the underlying debt. Rather, the purchasing intermediary, that would subsequently issue securities against its pooled holdings, would be a public entity with preferred creditor status, such as the European Stability Mechanism (ESM) or International Monetary Fund (IMF). Subordination is effectively created by providing the intermediary with first claim on sovereign holdings. The amount of underlying sovereign bonds that can be purchased from any issuer is limited in terms of their debt-to-GDP ratio (effectively setting the "subordination level"). This approach to creating a euro safe asset, dubbed "E-bonds", garnered a fair amount of official support following the sovereign debt crisis.

## ESBies

The third proposal, and perhaps the one which has received the most attention more recently, also applies tranching and pooling, only in this case in the form of creating securitised assets. The premise is that intermediaries – whether private or public – would be able to purchase a pool of underlying sovereign debt and issue tradeable securities backed by the underlying portfolio. These securities would be issued in tranches, with a senior and junior tranche (and potentially a mezzanine tranche). Purchases would be based along the lines of the ECB capital key and analysis suggests a senior tranche consisting up to 70% of the underlying face value of debt.

Dubbed "European Senior Bonds" ("ESBs" or "ESBies"), the most concrete proposal has been put forward by Brunnermeier et al. (2017) in the form of "Sovereign Bond-Backed Securities" (SBBS), and has received the detailed scrutiny and consideration of the European Systemic Risk Board (ESRB) High-Level Task Force as well as a public consultation by the European Commission. In May 2018 the European Commission put forward proposed regulation to facilitate the creation of SBBS and ensuring that they would receive the same regulatory treatment as sovereign bonds. Despite this attention, and some official sector enthusiasm, ESBies have been heavily criticised (and largely dismissed) by both private and public stakeholders. Identified challenges include the potential for creating a liquid market (with the possibility of multiple issuers and a lack of fungibility) as well as the ability to sell junior tranches under stressed conditions.

## Supranational bonds

The fourth proposed approach involves creating safe assets in the form of supranational bonds that are issued either by an underlying euro area budget or a leveraged euro area sovereign wealth fund (*Ubide 2015*). Seniority for such bonds would be created by providing the budget or fund with first claim on any related revenues (such as tax income or member state EU budget payments). Such issuance (also known as "stability bonds") could also be used to support euro area fiscal stimulus. This has also been cited as a potential stepping stone toward the creation of a longer-term eurozone treasury.

## From proposal to reality

While there are a range of alternative proposals under consideration, and a series of challenges and limitations to circumnavigate, it would seem that there is broad consensus among public and private stakeholders of the benefits, and even the need, to create a euro safe asset. In doing so, a number of questions still need to be answered. These include whether issuance should be demand or supply led, the involvement of the private sector in its creation, and whether a safe asset market should be developed gradually or if a "big bang" approach should be taken. Variations on the four main proposals also deserve consideration, such as a proposed "temporary eurobill fund" (TEF). Effectively the pooling of short-term euro area issuance, this might not only be a manageable means of testing the water for safe assets, but it could also ease some of the strain being borne by the repo market in intermediating collateral flows, as well as creating a term risk-free reference rate for the euro area.

What seems certain, however, is that the discussions around a euro safe asset are likely to intensify as its creation becomes viewed as ever more critical for completing the triumvirate of monetary, banking, and capital markets union.

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# Market conventions for referencing SONIA

*By Katie Kelly*

## Background

RFR On 18 March, the Working Group on Sterling Risk-Free Reference Rates (the "Working Group") released a discussion paper on *Conventions for Referencing SONIA in New Contracts*, which was developed with inputs from market participants across the bond, loan and derivatives markets. Largely based on the conventions which have been used in recent SONIA-referencing FRN issues in the sterling market and SOFR-referencing FRN issues in the US dollar market, the discussion paper explores those conventions which the Working Group considers to be most significant for the sterling SONIA market, and where it therefore considers that providing more information would be beneficial to the market.

Aimed at market participants who are considering how to reference SONIA in new contracts, the intention of the discussion paper is to raise market awareness of the identified conventions for referencing SONIA, with a view to supporting market participants' relevant preparations. It is hoped that raising awareness of the identified market conventions could encourage the further adoption of SONIA by a broad range of market participants and could therefore help reduce the risks of fragmented liquidity. The discussion paper is also expected to help support and inform infrastructure providers and calculation agents who may be charged with developing the necessary system and other changes to enable end-users to reference SONIA consistently across markets and products.

The discussion paper does not explore the use of term SONIA in new contracts. A term SONIA rate may develop: according to the FSB's statement, *Interest Rate Benchmark Reform – Overnight Risk-Free Rates and Term Rates,* in July 2018, "… in some cases there may be a role for term rates, including RFR-derived term rates, or term rates derived from other liquid markets". But according to the Working Group's Statement, *LIBOR Transition and Development of a Term Rate based on SONIA: Next Steps*, "The [Working Group] … encourages LIBOR users to progress their transition from LIBOR to the greatest extent possible, independently of any further progress on the development of [term SONIA rates]". Further, the discussion paper stresses that market participants are free to choose their preferred conventions, so does not provide guidance or recommendations.

The discussion paper sets out the conventions which are used in well-established SONIA-referencing markets; these include SONIA futures contracts, and the overnight indexed swaps market, in which a fixed rate cash flow is exchanged for a floating rate cash flow indexed to an overnight interest rate (SONIA). The floating rate is calculated on a compounded basis using a formula which can be found in the ISDA definitions.

Notwithstanding the fact that they reference different risk-free rates, the market conventions which have been used recently in the SONIA-referencing FRN issues in the sterling market and Secured Overnight Financing Rate (SOFR)-referencing FRN issues in the US dollar market are both pertinent to the emergence of conventions in the sterling SONIA market. Each set of conventions is explored in detail in the discussion paper. There are two main differences in the two sets of conventions used in each market; compounding or simple averaging, and a lag mechanism or lock-out mechanism, as described further below.

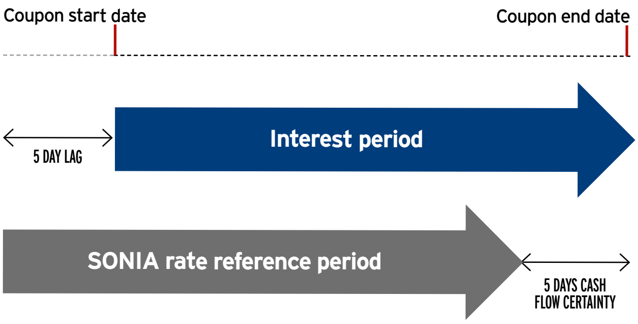
## Compounding or simple averaging

Interest on FRNs is typically paid quarterly (although it can be paid monthly, semi-annually or even annually). As SONIA is an overnight rate which is published the following day, that daily SONIA rate must be aggregated in some way over the relevant period to determine the interest amount for the period. In the SONIA-referencing FRN market, the daily rates are aggregated on a compounded basis. In the SOFR-referencing FRN market, a simple arithmetic average of the daily rates, which rolls over for a Friday rate for Saturday, Sunday and public holidays, is used instead. The discussion paper sets out some of the relative advantages and disadvantages of each approach, and highlights that for either method, it would be helpful for market participants if a third party were to publish a standard SONIA rate calculator or a SONIA screen rate for a given period, which is one of the priorities of the Infrastructure and Systems Workstream.

## Lag mechanism or lock-out mechanism

Given that the overnight SONIA rate is compounded (or can be averaged) over a period in order to derive the rate for a corresponding interest period, the rate for that interest period is only known at the end of the interest period. This is different to LIBOR, which acts as a forward-looking rate whereby the interest due at the end of an interest period is known at the beginning of that interest period.

But in order to achieve some degree of cash flow certainty before an interest payment is due, and to accommodate the period of time required from the operations point of view, the approach which has been used in the SONIA-referencing FRN market is to "lag" the SONIA rate reference period by five London banking days. This is illustrated in the figure below:




An alternative approach is to use a "lock-out" mechanism, which repeats one of the daily rates for the final few days of the calculation, which has been used in the SOFR-referencing FRN market. The discussion paper sets out some of the relative advantages and disadvantages of each approach, including considerations relating to varying the length of the lag period or the lock-out period.

## Margin

A further issue that the discussion paper considers is whether any margin which is added to the FRN should be compounded (or averaged) as part of the daily rate calculation or added to the already calculated (compounded or averaged) rate. As before, the discussion paper highlights considerations relating to each approach.

## Fallbacks

Pursuant to the EU Benchmarks Regulation (BMR), and in line with IOSCO *Statement on Matters to Consider in the Use of Financial Benchmarks*, market participants need to ensure that they have robust contractual fallbacks for SONIA. In addition, under the BMR, supervised users of all benchmarks must produce and maintain robust written plans setting out their planned course of action in the event of cessation or material change of a benchmark. The Bank of England, as administrator of SONIA, has contingency arrangements in place to enable continued SONIA publication (although these contingency mechanisms only apply to the overnight SONIA rate provided by the Bank of England (rather than any derived screen rate)). The discussion paper explains that some bond issuers have replicated the Bank of England arrangements in their fallback contractual language, but that market participants will have to consider their own needs to determine appropriate fallback contractual language.

## Alignment with other markets and cross-currency

The discussion paper explains that, hopefully, with the development of cash market conventions, it may become possible for swaps using the lag or lock-out mechanism to be cleared. But meanwhile, market participants operating across cash markets and derivatives markets should consider the extent to which greater alignment between these markets is necessary. In terms of differences in conventions between currencies in certain products, while they are not considered to be overly problematic, cross-currency coordination on alignment (which is under way, for instance in the US, through the ARRC, and is likely to continue elsewhere) would reduce complexity for end-users and is likely to become more important.

## Views on discussion paper

All interested market participants and infrastructure providers are encouraged to read the discussion paper and use its contents to support preparations for adopting SONIA in new products. There is an opportunity to contribute views on certain questions, which are set out in the discussion paper, by 30 April 2019.

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# Legacy sterling LIBOR bonds

By Charlotte Bellamy

## Summary

RFR The transition away from LIBOR is a global issue affecting various financial products in various currencies. One of the key questions for the bond market is how to deal with legacy bonds referencing LIBOR with a maturity beyond the end of 2021, when LIBOR may cease to be available. There is an increasing focus on this issue, with various authorities and other bodies commenting publicly on it. This article seeks to raise awareness of the issue by exploring the challenges and possible options for dealing with one segment of the market affected by the transition away from LIBOR, namely legacy sterling LIBOR bonds, drawing together various sources of publicly available information.

## Background

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.[1]

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 for which they must be prepared.[2]

To avoid the problems associated with LIBOR[3], the authorities want financial markets to transition away from LIBOR to alternative rates known as near risk-free rates, which are based on very liquid underlying markets. In all the LIBOR jurisdictions, the chosen risk-free rates are overnight rates: SONIA in the UK; SOFR in the US; €STR in the euro area; SARON in Switzerland; and TONAR in Japan.

In transitioning from LIBOR to risk-free rates, one of the key questions for the bond market is how to deal with legacy bonds referencing LIBOR with a maturity beyond the end of 2021, when LIBOR may cease to be available.

## The scale of the legacy LIBOR bond problem

It has been estimated that at least the equivalent of $864 billion bonds referencing LIBOR is currently outstanding and due to mature after the end of 2021. This estimate excludes some issues and issuers, such as sovereigns.[4]

Of that estimated total, roughly 80% references USD-LIBOR, 11% references JPY-LIBOR, 9% references GBP-LIBOR and 0.2% references CHF-LIBOR. Roughly 40% of the estimated total has a maturity date before the end of 2025, but over 43% has a maturity date beyond the end of 2034. This may include some perpetual instruments that reference LIBOR.

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

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

3. See further *The Transition from LIBOR to Risk-Free Rates* by Paul Richards, ICMA, originally published in the *ICMA Quarterly Report, First Quarter 2019*.

4. Source: Royal Bank of Canada Capital Markets.

## The challenges associated with legacy sterling LIBOR bonds

### *Traditional fallback provisions are likely to result in floating rate bonds becoming fixed rate bonds in the event that LIBOR is permanently discontinued*

Legacy bonds are likely to contain fallback provisions on how to calculate interest in the event that the nominated rate/screen page is unavailable. The fallback provisions in traditional legacy LIBOR bonds will typically depend on reference banks providing quotes for the relevant rate. In the context of LIBOR discontinuation, reference banks may not be willing to provide quotations on a voluntary basis. The majority of floating rate bonds are also likely to provide that, as an ultimate fallback, where the interest rate cannot be determined through the preceding fallbacks, then the rate defaults to the most recently calculated rate, for an earlier interest period.[5]

In the context of a permanent discontinuation of LIBOR, this would effectively result in the floating rate bonds becoming fixed rate bonds, because the last determined rate would be applied for the remainder of the life of the bond. This may be commercially unacceptable for both the issuer and investors. From an investor perspective, such issues may become illiquid and may cease to perform the commercial purpose investors intended for them. From an issuer perspective, those that aim to match liabilities via other instruments may be adversely affected.[6]

In the light of this, market participants and authorities are considering various options for avoiding a situation in which a large majority of legacy LIBOR bonds become fixed rate instruments. Some of those options are discussed in this article.

### *An industry protocol of the type used in the derivatives market cannot be used to amend bond contracts*

While an industry-level framework could help to facilitate the process for amending bond terms and conditions (see further below), it is not possible to amend bond terms and conditions using an industry protocol such as those used in the derivatives market. There are several reasons for this. One reason is that bond contracts do not envisage amendment by way of an industry protocol. Another is that bond terms and conditions are not completely standardised.

### *Bond trustees are unlikely to be able to use their discretion to agree to necessary amendments*

As indicated in an ICMSA Bulletin, *The Discontinuation of LIBOR/IBORs - Implications for English-law Note Trustees*, except in very rare cases (where transaction documents and terms and conditions explicitly allow), it will not be within a bond trustees' power to exercise its discretion to amend bond documents to cater for a permanent discontinuation of LIBOR. In addition, not all bond issues involve a trustee.

### *Bonds are, by their nature, freely transferable and often widely distributed to a variety of investors*

Bonds are freely transferable and often widely distributed. A single bond may be held by a large number (eg several thousand) investors. The issuer is unlikely to know the identity of the ultimate beneficial owners (or "investors"). This contrasts with the loan market, which (even in a syndicated context) is likely to involve a smaller number of lenders, the identity of whom will be known by the borrower.

In addition, bond market participants include not only financial institutions, but also "real economy" entities such as corporates, pension funds and insurance companies, as well as central banks and sovereign and supranational agencies. Legacy bonds may also be held by retail investors. This needs to be taken into account when considering any approach to handling legacy LIBOR bonds.

### *Options for handling legacy sterling LIBOR bonds*

The following options for handling legacy sterling LIBOR bonds are discussed further below:

- consent solicitation and other liability management exercises; and
- the possibility of legacy sterling LIBOR bonds continuing to reference sterling LIBOR in some form.

This article does not consider legislative intervention, which would be a matter for the authorities.

### *Consent solicitation and other liability management exercises*

Bonds will typically contain provisions allowing their terms and conditions to be amended by way of bondholder consent. This usually involves the issuer proposing

5. See *New Issuance of Sterling Bonds Referencing LIBOR*, published by The Working Group on Sterling Risk-Free Reference Rates, July 2018.

6. See *New Issuance of Sterling Bonds Referencing LIBOR*, published by The Working Group on Sterling Risk-Free Reference Rates, July 2018.

certain changes to the terms and conditions of the bond, either by way of written resolution or by convening a bondholders' meeting. Bondholders can then vote on the proposed changes. If the necessary quorum and/or consent thresholds are reached, then the proposed amendments will be made to the terms and conditions of the bond.

This process could be used to amend legacy sterling LIBOR bond terms and conditions so that they reference an alternative rate going forward or include alternative fallback provisions which would be less likely to result in the bond becoming a fixed rate instrument in the event of a permanent discontinuation of sterling LIBOR.

Each bond would need to be amended individually in order to ensure that the changes were legally valid. It is possible to envisage that some of the terms of the proposed amendments, and potentially other aspects, could be agreed at an industry level and set out in some form of industry framework document or "code". The framework or "code", while not having any binding effect, could be endorsed by relevant authorities and market participants could adhere to it publicly to indicate that they accept its terms at an industry level. This could increase the chances of success for legacy sterling LIBOR bond consent solicitations because it could (a) reduce some of the administrative burdens for issuers and investors and (b) give issuers more confidence in launching a consent solicitation if they are able to see that a large number of investors have indicated publicly that they accept (at an industry level) the terms that the issuer will be proposing.

It is important to note, however, that even with such an industry framework or code in place, each bond contract would need to be amended individually. In other words, adherence to such an industry framework or code would not be effective in amending bond contracts automatically.

There are several significant challenges associated with a consent solicitation approach for handling the legacy LIBOR bond issue.

- The first challenge is that this option is entirely voluntary. It depends upon issuers proposing, and investors accepting, the changes. Both issuers and investors will want (and need) to act in their best commercial interests. In particular, investors will need to act in accordance with their fiduciary duties to their clients and issuers will need to act in the interests of their shareholders. This means that, in order to succeed, the proposed amendment to the bond would need to result in an outcome that is, to the largest degree possible, in both the issuer's and investors' commercial interests. The extent to which this can be achieved in practice is unpredictable and would depend in part on prevailing interest rate conditions at the time any consent solicitation is launched.
- Consent solicitations can be very time consuming, administratively burdensome and expensive for both issuers and investors, particularly in the context of LIBOR discontinuation where they would need to be conducted in respect of a high number of bonds. It is also not clear whether the service providers who would need to be involved in the consent solicitation process (eg law firms, investment banks, clearing systems, paying agents and others) could cope with a high number of consent solicitations being launched at the same time.
- There are likely to be additional practical challenges and considerations for securitisations, capital securities and structured products, which could impact the efficacy of this approach for those products.
- Issuers and investors would need to consider how any change made to bond terms and conditions pursuant to a consent solicitation would impact upon their hedging arrangements.
- Finally, consent thresholds for some bonds (particularly those that are governed by New York law or have been distributed in the US) may be set at 100%. Therefore a consent solicitation approach may not be viable for those legacy LIBOR bonds. However, a consent threshold of 100% is likely to be most prevalent in US dollar denominated legacy LIBOR bonds and rarer in sterling legacy LIBOR bonds.

Some issuers may also wish to consider other forms of liability management exercise, such as offering bondholders alternative securities or cash in exchange for legacy bonds, repurchasing legacy bonds on the open market or exercising any call options in legacy bonds in order to redeem them. These liability management exercises could be used in conjunction with a consent solicitation and/or in combination with each other. However, many of the challenges noted above would apply in the context of these approaches as well.

Overall, consent solicitation or other forms of liability management exercise may be an option for some legacy LIBOR bonds, but it seems unlikely that it will be a solution for all legacy LIBOR bonds.

### *The possibility of legacy sterling LIBOR bonds continuing to reference sterling LIBOR in some form*

In January 2019, the FCA raised the "potential solution of allowing continued publication of LIBOR for use in legacy instruments that do not have mechanisms to remove their dependence on LIBOR".[7] This followed a previous speech

7. Edwin Schooling Latter, Director of Markets and Wholesale Policy at the FCA: *LIBOR transition and contractual fallbacks*, 28 January 2019

given by Andrew Bailey of the FCA in July 2018, in which he discussed the concept of LIBOR being continued for legacy instruments when it is not available for new business; either on its current basis or by "adding appropriate term credit spreads to overnight risk-free rates".[8]

As acknowledged by the FCA, the idea of LIBOR being continued on its current basis (ie on the basis of continued panel bank submissions) "might seem like an easy way out".[9] IBA (the benchmark administrator for LIBOR) has surveyed market participants in order to identify the LIBOR settings that are most widely used and has stated that it will work with globally active banks to seek to publish certain LIBOR settings after year-end 2021, with the aim of providing those settings to users with outstanding LIBOR-linked contracts that are impossible or impractical to modify. However, IBA states that there is no guarantee that any LIBOR settings will continue to be published after year-end 2021[10] and, as noted above, the FCA and others have made it clear that the future of LIBOR cannot be guaranteed beyond the end of 2021.

There are also challenges associated with the alternative idea discussed in Andrew Bailey's July 2018 speech of continuing to publish LIBOR but adjusting its methodology so that it becomes based on an overnight risk-free rate plus an adjustment spread. In particular, the FCA drew attention to the following:

- "We have not seen a compelling answer to how one-month, three-month, six-month and twelve-month term bank credit spreads can be reliably measured on a dynamic and daily basis. … the term credit spread would almost certainly need to be fixed rather than dynamic because of the lack of market to measure."
- "There is also the issue of how to address the term element of the risk-free interest rate. A calculation based on compounding of the realised overnight rate over the relevant term can work as a fallback to LIBOR in derivatives contracts in which arrangements for calculation of payment can also be amended. It is not clear how it could work more generally as a synthetic LIBOR. Many in cash markets would not be able to adjust their contracts or systems to accommodate this type of payment structure."
- "It should be clear to current LIBOR users that they must not rest any hopes in a synthetic solution to continuing LIBOR publication."

## Conclusion

This article has discussed some of the challenges associated with legacy sterling LIBOR bonds in the context of a permanent discontinuation of LIBOR and possible options to handle that issue. At the moment, there is no clear option or combination of options that has emerged as the best way of tackling the issue surrounding legacy LIBOR bonds. What is clear is that market participants need to prepare for the possibility that LIBOR will not be available at the end of 2021 and consider what that means for their legacy LIBOR bonds. This is a big task and ICMA will aim to support its members with this process by continuing to engage with authorities and members on this important topic. More information on ICMA's activities in this area is available on the ICMA benchmark reform and transition to risk-free rates webpage.

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

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

10. See https://www.theice.com/iba/ice-benchmark-administration-survey-on-the-use-of-libor .

# 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:

### Primary markets

1. *Public sector issuers:* The Public Sector Issuer Forum (PSIF) met in Vienna on 15 March to discuss prospects for bond markets in the next ten years, and a range of other subjects, including Brexit and the transition from IBORs to risk-free rates. Jingdong Hua, Treasurer of the World Bank, has joined the PSIF Steering Committee, which also includes Frank Czichowski, Treasurer of KfW, and Anne Leclercq, Head of the Belgian Government Debt Management Office.
2. *ICMA Primary Market Handbook:* Various updates to the ICMA Primary Market Handbook were published in December and in March, 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.
3. *ICMA Primary Market Forums:* ICMA held Primary Market Forums in Hong Kong, Mumbai and Bahrain on 26 February, 7 March and 13 March.
4. *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.
5. *US special resolution regimes:* ICMA has published on its website a guidance note and a 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.
6. *Prospectus Regulation:* ICMA provided feedback to the European Commission on its draft Level 2 delegated regulation and disclosure annexes on 21 December and has engaged informally with the Commission since then.
7. *PRIIPs Regulation:* ICMA responded briefly to the ESAs' joint consultation paper concerning amendments to the PRIIPs KID.
8. *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.
9. *Auditors:* ICMA has responded to two UK consultations relating to proposals to split the Big Four (and possibly other firms) between their audit functions and other services they provide to clients with a view to improving robustness and reducing potential conflicts of interest in the audit process. ICMA has also engaged with PwC in relation to its proposed uniform engagement letter for SAS-72 issuance.
10. *FATCA:* ICMA has circulated an updated version of its suggested FATCA language for vanilla debt programmes of non-US issuers to reflect recent regulatory developments.

### Secondary markets

11. *ICMA SMR&R:* ICMA is consulting members, on an ongoing basis, 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. In particular, the working group will look to revise the ICMA buy-in rules in light of the new CSDR requirements.
12. *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.
13. *CSDR settlement discipline:* ICMA has established a dedicated working group focused on the practical challenges of implementing the CSDR settlement discipline provisions, in particular the new mandatory buy-in framework. The CSDR buy-in provisions will come into force in September 2020 and will also apply to non-EU/EEA domiciled trading entities. ICMA is in ongoing discussions with ESMA, including on 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 on the establishment of a pass-on mechanism. In addition, ICMA is looking to raise awareness of the scope and obligations of the CSDR, particularly among buy-side and non-EU members.

14 *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.

15 *MiFID II/R data quality:* ICMA has established a MiFID II/R data quality task force which has identified key challenges and provided practical solutions related to MiFID II post-trade data. The objective of the task force is to work with ESMA in improving the existing data structures and systems. A meeting was held with ESMA on 2 April.

### *Repo and collateral markets*

16 *ICMA European Repo and Collateral Council (ERCC):* The ERCC met in Luxembourg on 31 January, and the results of elections to the ERCC Committee were announced on 6 February, with a wide range of international representation from across the industry.

17 *SFTR implementation:* ICMA is continuing to help members to implement the EU Securities Financing Transaction Regulation (SFTR), through the ICMA ERCC SFTR Task Force. In early March, ICMA launched an updated SFTR webpage with more details on the ERCC's work in relation to the extensive reporting requirements to be introduced by SFTR, and has issued an SFTR update e-mail.

18 *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 (CMH-TF). In response to a CMH-TF consultation on a set of harmonisation standards in relation to corporate actions, ICMA has submitted informal high-level considerations focusing on primary market-related concerns, based on input from ICMA's Primary Market Practices Committee.

19 *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. Various follow-up discussions are being conducted with official institutions.

20 *ICMA ERCC Guide:* A revised and updated version of the ICMA *ERCC Guide to Best Practice in the European Repo Market* was published on ICMA's website on 21 December. Subsequently, on 17 January, an updated version of ICMA's *Frequently Asked Questions on Repo* was also published on the website.

21 *Intraday liquidity:* The ERCC continues to analyse the important challenges around intraday liquidity management for the industry. Following a successful cross-industry workshop on the topic held in September, the ERCC is focusing in particular on the need for further alignment and on market practice in relation to shaping and partialling.

22 *Technology:* The ERCC is assessing the important impact of technology on repo markets and collateral management. In this context, ICMA is working closely with ISDA to assess the possibility to extend ISDA's work on a Common Domain Model (CDM) for derivatives to other asset classes, in particular SFTs. ISDA outlined its CDM project at the latest ERCC AGM in Luxembourg.

23 *Repo market at year-end:* On 15 January, the ERCC published a briefing note on the conditions in the European repo market at 2018 year-end, following up on similar studies published in 2016 and 2017. Compared with the previous two year-ends, 2018 was relatively uneventful in Europe.

### *Sustainability*

24 *Integrating sustainability risks and factors in MiFID II:* ICMA responded to this ESMA consultation primarily from the perspective of the Primary Market Practices Committee and Legal & Documentation Committee. The response focused on the need to clarify terminology and references to green labels and standards in the market, while noting the absence of any concerns in the context of ICMA1/ICMA2.

25 *Integrating sustainability risks and factors in the UCITS Directive and AIFMD:* ICMA responded through the AMIC Sustainable Finance Contact Group on 19 February to the ESMA consultation on integrating sustainability risks and factors in the UCITS Directive and AIFMD. AMIC agreed overall with ESMA's principles-based approach. However, AMIC has suggested some clarifications to the technical advice, including (i) limiting the coverage to "risks" and not "factors", (ii) strengthening the materiality of sustainability risks and (iii) preferring "sustainability" to "ESG" risks for consistency purposes.

26 *Climate change and green finance:* ICMA responded to this FCA discussion paper by aligning with the view that climate change risks are likely to have a significant impact on financial markets and expressing its support for voluntary disclosures as recommended by the Task Force for Climate-related Financial Disclosure (TCFD).

27 *Usability of the EU Taxonomy:* ICMA responded to this EU consultation primarily from the perspective of the GBP. Support was expressed for a taxonomy that would determine environmental sustainability and be complementary to the existing GBP project categories

and other green taxonomies. Concerns were, however, raised on certain proposed thresholds for sustainability (eg green buildings and energy efficiency) that go significantly beyond current levels for eligible green projects and could impact both existing and future green bond issues.

28 *ESMA guidance on CRA disclosure:* ICMA responded to this ESMA consultation primarily from the perspective of the Corporate Issuer Forum. Support was expressed for more and better disclosure on unsolicited ratings in credit rating agencies' press releases, and for efforts to improve the quality and consistency of ESG-related disclosures in credit ratings and outlooks.

29 *Sustainable finance in emerging markets:* ICMA responded to the IOSCO consultation on sustainable finance in emerging markets and the role of securities regulators.

### Asset management

30 *Covered bond legislation:* The ICMA Asset Management and Investors Council (AMIC) Covered Bonds Investor Council (CBIC) Secretariat has briefed members on the outcome of the recently agreed covered bond legislation and will now prepare for the Level 2 process which is due to be under way by the middle of 2019.

31 *Securitisation:* On 31 January, the AMIC Securitisation Working Group published a short guide to the due diligence requirements in the EU STS Securitisation Regulation. The guide provides a primer for investors in the securitisation markets.

32 *Leverage:* The AMIC Fund Liquidity Working Group responded on 1 February to an IOSCO consultation on leverage in investment funds. AMIC welcomed the focus by IOSCO at each fund level on the potentially risky activities of asset managers as compared to an approach at management company level. In addition, AMIC agreed with IOSCO's proposed two-step approach to measuring risk associated with leverage but recommended that the gross notional exposure (GNE) figure is combined with the net notional exposure (NNE) figure to filter potentially risky funds.

33 *Liquidity stress testing:* On 8 January, AMIC and EFAMA published their third joint report on systemic risk in asset management, focusing on liquidity stress testing in investment funds. Subsequently, on 28 March, AMIC responded to ESMA's consultation on liquidity stress testing in UCITS and AIFs. AMIC was supportive of ESMA's overall approach but cautioned that 18 months' implementation time was necessary for firms. AMIC also cautioned against use of the bid-ask spread for asset managers.

34 *AMIC Conference:* An AMIC Conference was held in Amsterdam on 7 March.

### FinTech in capital markets

35 *Primary markets technology mapping directory:* 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, and is being kept up-to-date.

36 *FinTech meetings with regulators:* ICMA held meetings with DG FISMA and DG Connect on 25 January to discuss FinTech and legislative, regulatory and other developments.

37 *ECB FinTech Task Force:* ICMA, through the ERCC Ops FinTech Working Group, has been invited to join the ECB's Harmonisation Steering Group's FinTech Task Force, a sub-group of the AMI SeCo. ICMA contributes, for example, to the mapping exercise of post-trade technology solutions, as well as discussions on tokenisation of securities.

38 *IOSCO FinTech Network:* ICMA, an affiliate member of IOSCO, has joined the IOSCO FinTech Network, and 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

39 *Bundesbank/ICMA meetings:* An ICMA delegation including senior representatives of ICMA Market Practice and Regulatory Policy Committees and ISDA visited the Deutsche Bundesbank on 18 February for discussions on market operations and financial stability issues.

40 *ICMA Regulatory Policy Committee (RPC):* Clare Bolingford, Deputy Head of Capital Markets at HM Treasury, joined the ICMA RPC meeting in London on 14 March.

41 *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; 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.

42 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*

## Prospectus Regulation

The new EU Prospectus Regulation is due to apply from 21 July 2019. Ahead of this, the European Commission and ESMA have been working on various subsidiary acts.

The key Level 2 acts that will be relevant for ICMA members are (i) a delegated regulation on prospectus format, content, scrutiny and approval and (ii) RTS on key financial information for the prospectus summary, data and machine readability of prospectuses, advertisements, prospectus supplements and prospectus publication. These items are discussed further below.

### *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. ICMA submitted its feedback on 21 December, as detailed in the last edition of this Quarterly Report. Many of ICMA's concerns stemmed from the fact that much of the detailed provisions had been redrafted from *ESMA's Final Report on Technical Advice under the Prospectus Regulation* (which had largely used existing provisions from the current Prospectus Directive regime, with which national competent authorities and market participants are familiar). In some cases, this had led to confusing or ambiguous disclosure requirements.

On 14 March, the Commission adopted a delegated regulation and related annexes – which ICMA is now reviewing with members.

ICMA understands that the European Parliament and Council have a three-month non-objection period, which can be extended for a further three months. If the European Parliament and Council do not object within the first three-month period or if, before the expiry of that period, both co-legislators inform the Commission that they will not object, then the delegated regulation is published in the *Official Journal* and will enter into force on the date specified in the delegated regulation.

### *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 Q4 2018 edition of this ICMA Quarterly Report for commentary).

On 14 March, the Commission adopted a delegated regulation and related annexes – which ICMA is now reviewing with members.

ICMA understands that the European Parliament and Council have a one-month non-objection period which can be extended by two further one-month periods. If the European Parliament and Council do not object to the RTS within the one-month non-objection period or if, before the expiry of that period, both co-legislators have informed the Commission that they will not object, then the RTS is published in the *Official Journal* and enters into force on the date specified in the RTS.

In addition to the Level 2 acts, there are also certain Level 3 provisions that will be of interest to ICMA members, namely ESMA's Guidelines on Risk Factors and Q&A on Prospectuses.

### *ESMA Guidelines on Risk Factors*

The new risk factor requirements under the Prospectus Regulation are likely to be a key area of focus for ICMA members. 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 Q4 2018 edition of the ICMA Quarterly Report for further details).

On 29 March, ESMA published a Final Report - *ESMA Guidelines on Risk Factors under the Prospectus Regulation* – which ICMA is now reviewing with members.

### ESMA Q&A on Prospectuses

On 28 March, ESMA published Questions and Answers on the Prospectus Regulation – which ICMA is now reviewing with members. (The preceding Questions and Answers Prospectuses 29th updated version under the Prospectus Directive continues to be publicly available.)

### Other prospectus-related matters

### ESAs review (Omnibus III)

ICMA has been monitoring developments relating to proposals to centralise approval of certain prospectuses with ESMA pursuant to the ESAs review (reported on page 29 of the Q4 2018 edition of the ICMA Quarterly Report).

On 21 March, the European Council issued a press release confirming the Council Presidency and the European Parliament reaching a provisional deal on a supervisory framework for European financial institutions. No related legislative texts had been published at the time of writing, but press reporting seems to indicate that responsibility for prospectus approvals will remain with Member State regulators.

### Brexit

On 15 March, ICMA updated its FAQs on the impact of Brexit in primary markets for its members. This includes 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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*Note: Charlotte Bellamy is now on parental leave. In her absence, members can contact Ruari Ewing (ruari.ewing@icmagroup.org) for information on the EU Prospectus Regulation.*

## ICMA Primary Market Handbook: recent updates

On 26 March, ICMA published certain 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 are set out below.

- An amendment to Recommendation R6.4 (*Access to distribution*) to clarify that the Recommendation remains subject to any issuer objection that is in writing.
- In the case of Appendices A8 (*Final terms and pricing supplement*), A13 (*Selling restrictions and legends (EEA PRIIPs Regulation, EEA Prospectus Directive, UK*)) and A16 (*Sub-€100,000 denomination bonds under the EEA Prospectus Directive and retail cascade legends*), to include or update a notice that the standard language is being revised in the light of the UK's withdrawal from the European Union and draft revised language is available to ICMA members and Handbook subscribers on request.
- Also, in the case of just Appendix A8 (*Final terms and pricing supplement*), to remove the free text option in relation to completing CFI and FISN information.
- An update to Appendix A13a (*Selling restrictions (Hong Kong and Singapore)*) further to the implementation of Singapore's Securities and Futures (Offers of Investments) (Securities and Securities-based Derivatives Contracts) (Amendment) Regulations 2018.

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 new EU Prospectus Regulation is due to apply from 21 July 2019.**

## Other primary market developments

*Auditors:* ICMA responded to two UK consultations (by the UK Financial Reporting Council and by the UK Competition and Markets Authority) relating to proposals to split the "Big Four" (and possibly other firms) between their audit functions and other services they provide to clients with a view to improving robustness and reducing potential conflicts of interest in the audit process.

*FATCA:* ICMA has circulated an updated version of its suggested FATCA language for vanilla debt programmes of non-US issuers to reflect recent regulatory developments.

*MiFID II/R:* On 15 March, ICMA responded to a German Ministry of Finance consultation on MiFID II (with primary market coverage essentially referencing ICMA's report on *MiFID II and the Bond Markets: The First Year* published on 6 December 2018).

*Integrating sustainability risks and factors in MiFID II:* ICMA also responded to an ESMA consultation primarily from the primary market perspective. The response focused on the need to clarify terminology and references to green labels and standards in the market, while noting the absence of any concerns in the context of the ICMA1/ICMA2 approaches to product governance.

*ECB AMI-SeCo:* In response to a CMH-TF consultation on a set of harmonisation standards in relation to corporate actions, ICMA submitted informal high-level considerations focusing on primary market-related concerns.

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# ESMA guidance on CRA disclosure

*by Katie Kelly*

In December 2018, ESMA released a consultation on *Guidelines on Disclosure Requirements Applicable to Credit Ratings* (the consultation) to which ICMA responded on behalf of the ICMA Corporate Issuer Forum. ICMA feedback on the consultation was restricted to two specific areas: first on disclosure requirements for credit rating press releases, with particular focus on unsolicited ratings, and second on guidelines relating to environmental, social and governance (ESG) factors under the Credit Rating Agency (CRA) Regulation.

### *Disclosure requirements for CRA press releases: unsolicited ratings*

It is important that end-users of ratings understand the significance, scope and limitations of unsolicited ratings. One of the dangers of an unsolicited rating is that it may be in direct contradiction to the existing, solicited ratings of an issuer, which may result in confusion for the user. This could be harmful to the reputation of the issuer, and could also result in the issuer's bonds being included in a different (wrong) index.

It is also important for users to understand the basis upon which the unsolicited rating is released; this could inform how a user treats the unsolicted rating, or the importance it attaches to it. Usually, an unsolicited rating will be based on publicly available information, and while a CRA *may* share drafts of its report with an issuer, is not compelled to do so. In any event, any such communication with an issuer may only extend to a discussion of the publicly available information and correcting factual errors. For these reasons, the quality of the unsolicited rating may be based on an ill- and/or under-informed assessment of the issuer, and is not likely to match the calibre of a solicited rating. This is particularly the case if there is not an existing relationship between the issuer and the CRA (or individual analyst) upon which a more informed judgment-based view can be formed by the CRA, rather than short-term, knee-jerk reaction based on publicly available information.

Currently, the CRA Regulation provides that a prominent statement is required (i) that the rating is unsolicited using clearly distinguishable colour code and (ii) as to whether the CRA had access to the accounts, management or other relevant documents for the entity.

Often, unsolicited reports are published without the issuer's knowledge. The response therefore suggests that, at the very least, the CRA should be required to specify unambiguously, clearly and visibly at the top of every page of the press release (and associated report, if any) the fact that the ratings were unsolicited. Ideally, a similar requirement would apply to communication of unsolicted ratings by CRAs to other platforms, as well as to other data providers who are replicating the rating without signalling whether it is solicited or not.

The consultation proposes a schematic which requires an indication of participation of the issuer, and an indication of whether access to accounts was granted. The response stresses that it is important to qualify and quantify the level of the issuer's participation beyond simply box-ticking, and that the schematic therefore needs to extend to be much more descriptive of the levels of participation, including whether access was granted to non-public information by the issuer.

### *ESG factors under the CRA Regulation*

Generally, the response indicates that ICMA welcomes efforts to improve the quality and consistency of ESG-related disclosures in credit ratings and outlooks, which could give users greater clarity and information on whether, and how, ESG criteria have been considered as part of a credit rating or outlook.

ICMA agrees with the proposed requirement to include a reference and link to the relevant section of the CRA's website where the ESG material can be found, or a document explaining how ESG factors are considered within the credit rating methodologies, so long as these various resources are as tangible and understandable as possible and are regularly updated to reflect any developments.

The consultation contains a proposal to positively identify where ESG factors are or *are not* a key element behind a credit rating; while the response supports this initaitive, it also highlights the difficulties with this approach. Depending on the nature of the issuer's business, it could be challenging to isolate in all cases where a particular ESG element is, or importantly, is *not* a key underlying element. Often, environmental and social risk is inextricably weaved into the business and financial risk profile of an issuer, in the country profile of the issuer or in the wider geopolitical environment, so to unravel the genesis of the ESG factors and apply them in a way that shows direct correlation to the risk profile of an issuer may be a challenge, and also may give a disproportionate view (positive or negative) of the actual effect of the ESG factor on the issuer and/or its rating.

The response also recommends that the guidelines should include commentary regarding how material or otherwise the ESG factor is (as well as in the context of all other considerations which are taken into account when assigning a rating), or how an issuer is managing the particular ESG issue; the absence of any such qualitative statement could be misleading in that a user might attribute more importance to a particular ESG factor than is merited.

The effects of ESG risks on a rating are not necessarily quantifiable financially, but rather could come down to a matter of judgement. The response therefore suggests that the CRA should set out its criteria for benchmarking ESG factors in terms of risk and in terms of materiality.

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**ESMA has substantially expanded the ability for reporting entities to use the "No Data" options in the respective disclosure templates, in particular in the templates for ABCP securitisation.**

### *Asset-Backed Commercial Paper (ABCP)*

A statement on ESMA's near-term implementation of the EU STS Regulation was published on 11 January 2019. This statement aims to provide additional information to facilitate market participants' understanding of several aspects of ESMA's implementation of its responsibilities deriving from the EU STS Regulation, which began to apply on 1 January.

On 31 January, ESMA published an opinion containing a revised set of draft regulatory and implementing technical standards (disclosure RTS/ITS) under the EU Securitisation Regulation, which concern the details of a securitisation to be published by the originator, sponsor and Securitisation Special Purpose Entity (SSPE), as well as the relevant format and templates. This opinion is ESMA's response to the European Commission's letter of 30 November 2018 (Annex 1), received on 14 December, requesting certain amendments to the disclosure technical standards published in ESMA's Final Report on 22 August 2018.

ESMA agrees with the Commission's requests to amend its disclosure RTS/ITS and, accordingly, has substantially expanded the ability for reporting entities to use the "No Data" options in the respective disclosure templates, in particular in the templates for ABCP securitisation. In addition, ESMA has also adjusted the content of certain fields in the templates, where it considered that this could more appropriately address the European Commission's request. ESMA has also clarified the templates to be used to provide any inside information as well as information on significant events affecting the securitisation (under (f) and (g) of Article 7(1) of the Securitisation Regulation). The Commission will now consider endorsement of these revised RTS/ITS and the XML schema for these templates shall be made available in the coming months.

Also on 31 January, the UK PRA and FCA published the final direction on the manner in which firms must make information regarding private securitisations available to their UK competent authorities. This direction, which comes into effect from 31 January, is applicable to all UK established originators, sponsors and SSPEs. The direction includes certain specific details relating to the cases of a private ABCP programme where the sponsor or SSPE of the ABCP programme is established in the UK, and of private ABCP transactions under an ABCP programme where neither the sponsor nor the SSPE of the ABCP programme is established in the UK. The annex to this statement includes the template to be used for notifying the PRA and FCA.

On 19 March, PCS announced that it has been authorised as a third party verification agent by the UK FCA, thus allowing it to provide verifications for European originators of the STS status of their transactions in line with Article 27 of the EU STS Regulation, with immediate effect. On 21 March, PCS then provided answers to some questions received from market participants and set out the scope of their STS verification activity. The PCS website includes specific information relating to verification of the STS criteria of an ABCP conduit or a transaction within an ABCP conduit and details of its first STS verification, for Obvion's STORM 2019-I transaction.

On 22 March, it was announced that the ECB has decided that the loan-level data reporting requirements of the Eurosystem collateral framework will converge towards the disclosure requirements and registration process for securitisation repositories specified in the EU STS Regulation. The ECB has taken this decision with a view to promoting efficiency and standardisation in the securitisation market. The disclosure requirements of the EU STS Regulation will be reflected in the eligibility requirements for the acceptance of ABSs as collateral in the Eurosystem's liquidity-providing operations. In addition, the ECB will phase out its designation process for loan-level data repositories and will rely instead on the registration of securitisation repositories by ESMA, under the EU Securitisation Regulation.

The change in the Eurosystem's transparency requirements will come into effect after a transitional period of three months from the date on which two specified pre-conditions are fulfilled. For ABSs issued prior to 1 January 2019, which are not subject to the EU STS Regulation, the Eurosystem's current loan-level data reporting requirements will be maintained for a grandfathering period of three years after the date on which the change in the ECB's transparency requirements becomes effective.

Circulated on 18 March, AFME's *Fourth Quarter 2018 Securitisation Data Report* shows that European ABCP issuance was €97.6 billion in the fourth quarter of 2018. This is a decrease of 24.4% versus the prior quarter but represents an increase of 30.1% versus the same quarter in the prior year. Multi-seller conduits (99.4% of total), particularly from France (69.5% of total) and Ireland (26.2%), continue to dominate as the largest issuance category in the ABCP market. European ABCP issuance for full year 2018 was €404.3 billion, a welcome increase of 38.0% versus the prior year total.

In order to provide a comprehensive package of clarifications for market participants ESMA has developed a set of Q&A, published on 31 January, based on stakeholder feedback and questions on the disclosure technical standards received by ESMA since 22 August. These cover many technical issues on how to complete template fields and aim at providing guidance to market participants seeking further context that may be helpful for their future expectations of how to comply with these RTS/ITS. Nevertheless, they are being provided in advance of the possible adoption of the disclosure RTS/ITS being adopted by the EC and consequently, are subject to possible changes. ESMA's website also provides a, thus far very short, list of the STS notifications it has received.

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# Secondary Markets



*by Andy Hill, Elizabeth Callaghan and Gabriel Callsen*

## MiFID II/R: ESMA guidance in the first quarter of 2019

In the first quarter of 2019, 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) publication of annual transparency calculations of LIS and SSTI thresholds for bonds, (ii) liquidity assessments of bonds for Q4 2018 for transparency purposes, (iii) publication of data for the systematic internaliser calculations for bonds, and (iv) further ESMA guidance and Q&A updates. In addition, (v) selected ESMA guidance in relation to MiFID II/R under a no-deal Brexit scenario is referenced below.

### *(i) Publication of annual transparency calculations of LIS and SSTI thresholds for bonds*

On 18 March, ESMA published the results of the annual transparency calculations of the large in scale (LIS) and size specific to the instruments (SSTI) thresholds for bonds except for ETCs and ETNs. This publication was originally planned for 1 March 2019 in advance of the deadline of 30 April provided by Article 13(17) of the Commission Delegated Regulation (EU) 2017/583 (RTS 2), and as communicated in the statement on the use of UK data in ESMA databases and the performance of MiFID II calculations under a no-deal Brexit, published on 5 February 2019.

- The transparency requirements will apply from 1 June 2019 until 31 May 2020.

### *MiFID II/R – Q1 2019*

Overview of selected ESMA guidance:

28 March: Q&As on investor protection topics

18 March: Annual transparency calculations of the LIS and SSTI thresholds for bonds

4 February: Q&As on MiFIR data reporting

1 February: Liquidity assessments for individual bonds by ISIN for Q4 2018

1 February: Completeness indicators related to bond liquidity data

1 February: SI calculations for bonds

30 January: Update on SI calculations for derivatives (Q&As on transparency issues)

4 January: Q&As on transparency issues

Overview of selected ESMA guidance in case of a no-deal Brexit:

28 March: Update on preparations for a no-deal Brexit scenario

19 March: Statement in relation to the impact on ESMA's databases and IT systems

7 March: Statement on post-trade transparency for OTC transactions between EU investment firms and UK counterparties

5 February: Statement on the use of UK data in ESMA databases and performance of MiFID II calculations

| Bond Type | SSTI pre-trade | LIS pre-trade | SSTI post-trade | LIS post-trade |
|---|---|---|---|---|
| Corporate Bond | 300,000 | 1,500,000 | 2,000,000 | 4,000,000 |
| Convertible Bond | 400,000 | 1,500,000 | 2,000,000 | 2,500,000 |
| Other Public Bond | 300,000 | 2,500,000 | 4,500,000 | 8,000,000 |
| Covered Bond | 600,000 | 4,000,000 | 6,000,000 | 15,000,000 |
| Sovereign Bond | 600,000 | 5,500,000 | 8,000,000 | 15,000,000 |
| Other Bond | 300,000 | 1,500,000 | 1,500,000 | 3,500,000 |

*Note: The thresholds are denominated in EUR.*
*Source: ESMA*

- The results are published on a per bond-type basis in excel format in the annual transparency calculations for non-equity instruments register.
- The results on a per ISIN basis will be published through the Financial Instruments Transparency System (FITRS) in the XML files (available here) and through the Register web interface (available here) starting on 30 April 2019. ESMA will publish until 31 May 2019 two records with this type of calculation for each ISIN (the one applicable until that date, and the one applicable starting on 1 June).
- To avoid any misinterpretation of the results, users of the calculations are invited to review the FIRDS Transparency System downloading instructions document, in particular paragraph 28.

In this context, ESMA clarified on 4 January 2019 through a Q&A update on transparency topics that if the LIS and SSTI thresholds for a bond have not been published in ESMA's FITRS database or on the ESMA website, the relevant thresholds set out in Table 2.3 of Annex III in RTS 2 should apply by default.

### *(ii) Liquidity assessments of bonds for Q4 2018 for transparency purposes*

On 1 February, ESMA announced that the fourth quarterly liquidity assessment for bonds under MiFID II/R had been made available through FITRS in XML format. The list of ISINs was subsequently published through the FITRS interface. Accordingly, 439 bonds were deemed liquid in Q4 2018. The liquidity assessments are applicable from 16 February 2019 until 15 May 2019. However, additional data and corrections submitted to ESMA may result in further updates within each quarter, published in ESMA's FITRS, which will be applicable the day following publication.

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

On 1 February, ESMA released the data for the systematic internaliser (SI) calculations for bonds, equity and equity-like instruments. More specifically, ESMA has published the total number of trades and total volume over the period July-December 2018 for the purpose of the SI calculations for 417,288 bonds and 16,690 equity and equity-like instruments.

The results are published only for instruments for which trading venues submitted data for at least 95% of all trading days over the six-month observation period. The data publications also incorporate OTC trading to the extent it has been reported to ESMA. The publication includes data also for instruments which are no longer available for trading on EU trading venues at the end of December. Accordingly, volume data have been reported for 25,389 instruments out of 417,288 bonds 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 February 2019. Further information on the SI regime and calculations are available on ESMA's website.

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

With regard to investor protection topics, ESMA issued Q&A updates on 28 March in relation to the scope of RTS 27 reporting requirements for market makers and other liquidity providers, notably in the context of OTC transactions and pre-trade transparency waivers. Further clarifications relate to information on costs and charges and *ex ante* disclosure requirements, amongst other topics. Other updates include ESMA's Q&As on MiFIR data reporting released on 4 February, notably in relation to the technical reporting requirements of reference data of issuers' LEIs, bonds traded after the maturity date, and complex trades. On 1 February, ESMA furthermore published quarterly completeness indicators related to bond liquidity data submitted by trading venues. With regard to the SI calculations for derivatives (and other non-equity instruments excluding bonds), ESMA announced on 30 January 2019 that the publication of data will be delayed until at the latest 2020. It was stated that "additional work is required by ESMA, NCAs and trading

**Good post-trade data is essential for effective compliance with regulatory reporting obligations and the delivery of policy objectives for greater transparency and a more level playing field.**

venues to further improve the quality and completeness of submitted data."

### *(v) Selected ESMA guidance in relation to MiFID II/R under a no-deal Brexit scenario*

*(a) Update on preparations for a possible no-deal Brexit scenario on 12 April 2019:* On 28 March, ESMA issued a statement highlighting "that, in relation to previously published measures and actions issued on the basis of a no-deal Brexit scenario on 29 March 2019, reference to the date of 29 March 2019 in these statements should now be read as 12 April 2019."

*(b) Statement in relation to the impact on ESMA's databases and IT systems:* On 19 March, ESMA published a statement on its Data Operational Plan under a no-deal Brexit scenario on 29 March 2019. The statement covers actions in relation to the Financial Instruments Reference Data System (FIRDS), Financial Instrument Transparency System (FITRS), Transaction reporting systems, and ESMA's registers and data, amongst others.

*(c) Post-trade transparency for OTC transactions between EU investment firms and UK counterparties:* On 7 March, ESMA issued a statement on its approach to the application of some key MiFID II/MiFIR and Benchmark (BMR) provisions should the UK leave the EU under a no-deal Brexit. The statement covers post-trade transparency for OTC transactions between EU investment firms and UK counterparties, amongst other provisions. In case of a no-deal Brexit, investment firms established in the UK will no longer be considered EU investment firms but will fall into the category of counterparties established in a third country. In consequence, EU investment firms are required to make public transactions concluded OTC with UK counterparties via an APA established in the EU27. This approach ensures that all transactions where at least one counterparty is an EU investment firm will be made post-trade transparent in the EU27.

*(d) Statement on the use of UK data in ESMA databases and the performance of MiFID II calculations:* On 5 February, ESMA released a statement to inform stakeholders on the approach it will take on all ESMA IT applications and databases in relation to MiFID II calculations *under a no-deal Brexit scenario*. The statement addresses reference data, transparency calculations for non-equity instruments as well as calculations for systematic internaliser (SI) determination, amongst other items.

As a general approach, reference data submitted by UK trading venues and systematic internalisers (SIs) to FIRDS will be terminated taking effect on Brexit. Also, with effect from Brexit the FCA will cease to be the relevant competent authority (RCA) for any EU-traded instruments. [...]

In the case of a no-deal Brexit, ESMA will freeze the quarterly calculations for the SI determination for equity instruments and bonds, the quarterly determination of the liquidity status of bonds and the monthly DVC publications [for equities] for a period of two months after [Brexit] due to concerns about the temporary disruption of the ESMA IT applications and databases. This implies that ESMA will not perform the calculations for the quarterly SI determination for equity instruments and bonds and for the quarterly liquidity determination for bonds scheduled for 1 May 2019. The calculation and publication of the quarterly bond liquidity and SI determination for equity instruments and bonds will be resumed for the next regular publication date on 1 August 2019. [...]

Furthermore, ESMA will move forward the publication of the annual calculations for bonds (LIS- and SSTI-thresholds) from 30 April 2019 to 1 March 2019. The results of those calculations will be applied, as planned, from 1 June 2019.

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**Improvements are urgently needed and the best places to start are the database structures within ESMA.**

## MiFID II/R: improving post-trade data quality

Good post-trade data is essential for effective compliance with regulatory reporting obligations and the delivery of policy objectives for greater transparency and a more level playing field in Europe for bond trading.

Post-trade data is the by-product of MiFID II/R that was most eagerly anticipated by market participants. This data can be used in pre-trade decision making, execution counterparty identification and post-trade performance and analysis. Currently, post-trade data quality is sub-optimal and unusable.

ICMA believes that improvements are urgently needed and the best places to start are the database structures within ESMA. These database structures underpin the effective operation of MiFID II/R's transparency regime.

In order to tackle the challenges of post-trade data quality in the EU, ICMA's MiFID II Data Workstream created a task force on post-trade data quality. This task force gathered together data experts from trading venues and market data providers, sell sides and buy sides. The task force identified challenges and proposed solutions involving ESMA's two fundamental databases. These databases form the starting point and more or less "source" for bond data quality in the EU.

These ESMA databases are referred to as FIRDS and FITRS. "FIRDS" is the Financial Instruments Reference Data System and is a data collection infrastructure established by ESMA, in cooperation with EU national competent authorities (NCAs), covering financial instruments that are in scope of MiFID II/R. This database links data feeds between ESMA, NCAs and approximately 300 trading venues across the European Union.

The "FITRS" database or Financial Instruments Transparency System relies heavily on FIRDS master records for liquidity assessments for bonds subject to the pre- and post-trade transparency requirements in MiFID II. Both of these "headwater" databases impact all downstream bond data, one way or the other.

In January 2019, the data quality task force created a table of the identified FIRDS and FITRS data challenges and issues and proposed workable solutions. This table was sent to ESMA along with a proposal to meet and discuss further. ICMA believes the data quality task force, working together with ESMA specialists, will be successful in improving data quality in cash bond markets. There is also a view that these efforts will benefit data quality in other asset classes in addition.

ESMA responded to the ICMA study with keen interest in our proposals. Meetings are now taking place and the process of improving data quality, working in conjunction with ESMA, has begun.

The five key areas identified for improving data quality and the basis for our discussions follow:

1. FIRDS: publication times of daily delta files (DLTINS);
2. FIRDS: classification of financial instruments (CFI) code inconsistencies;
3. FITRS: knock-on effects (in FITRS) of FIRDS CFI code inconsistencies;
4. FITRS: duplicate records and missing information; and
5. FITRS: non-equity transparency quantitative data reporting instructions.

ICMA will report further progress on data quality in due course.

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## CSDR Settlement Discipline

The ICMA CSDR Settlement Discipline (CSDR-SD) Working Group is at the forefront in driving efforts and coordination to ensure bond market preparedness for the introduction of CSDR settlement discipline requirements in September 2020, in particular the new mandatory buy-in regime. From 13 September 2020, entities settling trades on EU/EEA CSDs and ICSDs will legally be required to initiate a buy-in process against any counterparty failing to settle a sell transaction for more than a few days (four business days in the case of liquid[1] equities and seven in the case of all other instruments including bonds). This legal obligation is intended to apply regardless of the jurisdiction of the trading parties.

Working closely with members, as well as with ESMA, ICMA intends to provide a framework for implementation of the CSDR buy-in requirements and related market best practice through its Secondary Market Rules and Recommendations which apply automatically to members transacting in international securities,[2] and which will be updated to reflect the regulatory provisions from September 2020. Importantly, the ICMA "Rules" will also aim to correct an error in the original Level 1 regulatory text which creates an unintended asymmetry in the settlement of the difference between the buy-in price and the original transaction price, which otherwise would create additional market risks not only for sellers of securities (both with respect to long- and short-sales), but also for lenders of securities.

ICMA's CSDR-SD Working Group consists of sell-side and buy-side fixed income traders, as well as operations, compliance, and legal experts. Given the significant impacts CSDR-SD is likely to have on the functioning of European bond markets, in particular credit and emerging markets, all member firms are encouraged to engage with the Working Group and to ensure that their relevant trading and non-trading staff are fully informed of its work to support implementation of the CSDR mandatory buy-in requirements.

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## The ICMA Secondary Market Forum

On 20 March 2019, ICMA held its inaugural Secondary Market Forum in Paris, hosted by Refinitiv. The event was an opportunity to showcase ICMA's extensive work related to fixed income secondary markets as well as engaging members and stakeholders on the key issues helping to shape and evolve the international bond market structure. Robert Ophèle, President of the Autorité des Marchés Financiers, provided a keynote address on *Trading in Fragmented Capital Markets* (which can also be found in the features section of this Quarterly Report), and Imène Rahmouni-Rousseau, Director of Markets Directorate, Banque de France, gave a speech on evolving market functioning in view of technology and the normalisation of monetary policies. Panels discussed the forces impacting bond markets (including regulation, monetary policy and geopolitical risks) and bond market structure evolution (including market participants, changing behaviour, the role of platforms, and new technologies).

In light of the success of this event, ICMA hopes that the Secondary Market Forum will become a regular highlight of its annual events calendar.

More can be found about ICMA's work in the international secondary bond markets on its website.

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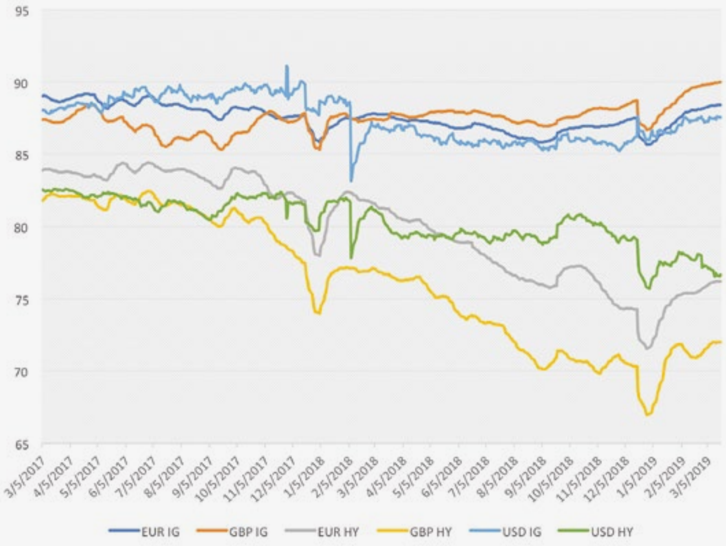
1. As determined by the MiFID II liquidity assessment

2. An international security is defined as a security intended to be traded on an international, cross-border basis (ie between parties in different countries), and capable of settlement through an international central securities depository or equivalent.

# ICE Data Services Corporate Bond Market Liquidity Tracker

**March 2019**

### *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 throughout 2018 followed by a drop at year-end. Subsequently, liquidity levels rebounded swiftly in Q1 2019 and, in the case of GBP IG, reached a two-year high.

EUR and GBP HY liquidity, however, shows a fairly steep decline throughout 2018, followed by a marked drop at year-end. Liquidity levels recovered throughout Q1 2019, reaching similar levels to Q3 2018.

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. However, a stable outlook on monetary policy and tightening CDS spreads seem to have countered this effect in Q1 2019. Meanwhile, the economic uncertainty arising from Brexit appears to remain an underlying factor of volatility in EUR and GBP HY.

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 Andy Hill and Alexander Westphal*


## SFTR implementation

Firms have been waiting eagerly to get more clarity on the implementation timeline for the extensive SFTR reporting requirements. The time of waiting finally came to an end on 22 March 2019, when the full package of SFTR Regulatory Technical Standards (RTS) and Implementing Technical Standards (ITS) was published in the EU's *Official Journal*. In total, this consists of 10 different delegated and implementing regulations, including the relevant RTS and ITS Annexes which include the actual reporting tables. With the publication of the RTS and ITS, the implementation timeline is now fixed. The RTS and ITS will enter into force on 11 April 2019, 20 days after their publication. This will kick off a formal transition period until the actual reporting go-live. Banks and investment firms will be the first ones to report, starting from 11 April 2020, or exactly 12 months after entry into force of the RTS and ITS. The requirements will then be gradually extended to other entities, including CCPs and CSDs (11 July 2020), the buy side (11 October 2020), and finally also to non-financial counterparties (11 January 2021). Some of these dates are on weekends. Where this is the case the effective go-live date will be on the first business day after the legal date. And unfortunately, 11 April 2020 – the initial go-live date – is Easter Saturday.

This leaves the industry exactly one year to prepare for the initial reporting go-live. While the scale of this implementation task is not to be underestimated, the work at the industry level is well under way. A number of trade associations are focusing heavily on SFTR, including the ICMA ERCC which is taking the lead in relation to repos and buy/sell-backs. As reported previously, the ICMA ERCC's dedicated SFTR Task Force covers a wide range of firms, including reporting firms, infrastructures and service providers. The group is working on agreed definitions and industry best practices in relation to SFTR reporting. One key document that is being developed is an Annex to the ERCC Guide to Best Practice which specifically focuses on SFTR reporting. The draft SFTR Annex already covers more than 60 questions and keeps on growing. It is complemented by further analysis, including a long list of sample reports covering a wide variety of repo trading scenarios which serve as an important reference point for firms and have helped to bring to light a number of problems and inconsistencies that still need to be tackled by the industry as well as regulators. Another focus more recently has been on the reporting of repo lifecycle events, as the group is trying to establish a consistent industry approach to report each of these. While the different documents are currently still working drafts, the plan is to make them more widely accessible in due course. More information on the work of the SFTR Task Force is already available today on ICMA's SFTR webpage.

Another important aspect of the work remains collaboration with ESMA, given their critical role in the implementation process. Besides ESMA's work on the RTS and ITS, they are also responsible for providing important additional implementation guidance, the so-called Level 3 measures. This work formally kicks off once the RTS and ITS are in force and will include Q&As, but also detailed additional Reporting Guidelines with concrete reporting examples and use cases to further guide reporting firms. The draft Guidelines are expected to be published in late April or early May for public consultation.

On a related note, it is also worth mentioning that the ERCC's SFTR Task Force has launched a separate workstream to focus on the transaction reporting requirements for certain SFTs under MiFIR. More specifically, this relates to SFTs concluded with EU central banks. While these transactions have been explicitly exempted from SFTR reporting, they have in turn been included in the scope of MiFIR reporting. MiFIR transaction reporting is of course already live, but SFTs will only have to be added to the scope once the SFTR regime goes live. This leaves some time for the ERCC and other industry groups to come up with a practicable approach – not an easy task given that the MiFIR regime has not been designed with SFTs in mind and is therefore not well-suited to cover the specifics of SFTs.

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## CSDR mandatory buy-ins and SFTs

As part of its broader work related to CSDR settlement discipline (CSDR-SD) measures as they apply to the European bond markets, ICMA is also focused on the implications and practical challenges related to securities financing transactions, in particular with respect to the mandatory buy-in regime. Working closely with the ERCC, as well as with ISLA and other market stakeholders, ICMA's CSDR-SD Working Group is looking to develop market best practice and request regulatory guidance in order to minimise the potential disruption to the functioning and liquidity of the European repo and collateral markets when the Regulation comes into force in September 2020.

ICMA's CSDR-SD Working Group consists of sell-side and buy-side fixed income and repo traders, as well as operations, compliance and legal experts. Given the significant impact that CSDR-SD is likely to have on the functioning of European bond and repo markets, member firms are encouraged to engage with the Working Group and to ensure that their relevant trading and non-trading staff are fully informed of its work to support implementation of the CSDR mandatory buy-in requirements.

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## Other regulatory reforms

On 5 February 2019, the European Commission welcomed the political agreement reached by the European Parliament and EU Member States on the targeted reform of EMIR, which will bring more proportionate rules for corporates. As part of this, some more time is granted to developing solutions for pension funds before they have to start clearing derivatives in CCPs and progress towards these clearing solutions will be carefully monitored. One potential solution concerns pension funds utilising repo markets in order to be able to raise any cash needed to meet CCP margin calls, but the viability of this depends upon the repo market being sufficiently liquid to meet such requirements at all times. During the time that has been granted, further work is needed to fully assess this challenge and consider what mitigants could be available to satisfy any concerns.

> **Investment firms will be the first ones to report, starting from 11 April 2020.**

On 15 February, it was announced that EU ambassadors had endorsed an agreement reached between the Romanian Presidency and the Parliament on a set of revised rules aimed at reducing risks in the EU banking sector. Among other things the package strengthens 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. Generally, these new rules should become applicable two years after the legislation comes into force, which will be 20 days after its publication in the *Official Journal*. The timing of this is uncertain but may be achieved this autumn, so it would then be autumn 2021 before the rules apply.

One important point to note from the associated text of the political agreement on the CRR, dated 14 February, is that (on page 470) Article 429b(5)(a) says: "the transactions are settled through the same settlement system or settlement systems using a common settlement infrastructure;". The relevance of this lies in the explicit inclusion of the latter portion of the wording "settlement systems using a common settlement infrastructure", which contemplates a scenario such as T2S. This makes clear that SFT netting for regulatory purposes can be possible, subject to the satisfaction of all the other applicable conditions (in Article 429b(4)), for transactions within the T2S environment.

Part seven, starting at Article 429 (on page 458 of the above text) of the CRR concerns the calculation of the leverage ratio, which broadly speaking enacts a common leverage ratio regime in the EU in line with the BCBS standard. It is important to note Article 451, disclosure of the leverage ratio, point 3 of which (on page 513) says: "In addition to points (a) and (b) of paragraph 1 of this Article, large institutions shall disclose the leverage ratio and the breakdown of the total exposure measure based on averages calculated in accordance with Article 99(5)." Article 99(5) (on page 135) requires the EBA to develop implementing technical standards specifying "which components of the leverage ratio shall be reported using day-end or month-end values", taking into account "how susceptible a component is to significant temporary reductions in transaction volumes" and "developments and findings at international level" (thus anticipating Basel's work – see below).

Title IV of the CRR (starting on page 405) concerns the NSFR, which broadly speaking enacts a common regime in the EU in line with the BCBS standard. Note that Article 428e provides that for purposes of the calculation SFTs with a single counterparty shall be calculated on a net basis, subject to the same netting conditions as apply for leverage ratio purposes (as referred to above). Also, for monies due from SFTs with financial customers that have a residual maturity of less than six months the RSF factor is 0% where the collateral qualifies as Level 1 assets for LCR (excluding extremely high-quality covered bonds) and so long as reuse is allowed for the life of the transaction (Article 428r(1)(fa)); and 5% otherwise (Article 428s(1)(ba)). This helps alleviate the asymmetry against the 0% ASF factor for equivalent sorts of SFT liabilities. Note that new Article 510(6) (on page 547) says that the EBA must review this treatment within two years of the application of the NSFR. Article 510(7) then gives the Commission one further year within which to propose any necessary change.

Article 513 of the CRR (on page 551) concerns macroprudential rules. "By 30 June 2022, and every five years thereafter, the Commission shall, after consulting the ESRB and EBA, review whether the macroprudential rules contained in this Regulation and Directive 2013/36/EU are sufficient to mitigate systemic risks in sectors, regions and Member States including assessing … how relevant EU and national macroprudential authorities can be mandated with tools to address new emerging systemic risks arising from credit institutions exposures to the non-bank sector, in particular from derivatives and securities financing transactions (SFT) markets".

As reported in this section of Issue no 52 of the ICMA Quarterly Report, on 13 December 2018, the BCBS published, for comment by 13 March 2019, a consultative document entitled *Revisions to Leverage Ratio Disclosure Requirements*. The ICMA ERCC responded to this consultation, welcoming the proposed revisions to leverage ratio Pillar 3 disclosure requirements to include disclosures of the leverage ratio exposure measure amounts of SFTs, which should help to eliminate the excessive volatility that has been seen on or around reporting dates (such as quarter-ends). Nevertheless, the ERCC continues to have some concerns about excessive restrictions in the repo market, arising from the cumulative effect of regulations over the past several years. Accordingly, alongside the proposed introduction of daily average-based leverage reporting for SFTs, it is considered to be important that the BCBS revisits recommendations for potential targeted refinements to the calibration of the leverage ratio, in order to safeguard the provision of sufficient market capacity and repo availability.

> **The ERCC continues to have some concerns about excessive restrictions in the repo market, arising from the cumulative effect of regulations.**

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## Repo and collateral-related research

Published on 31 January, *From Cash- to Securities-Driven Euro Area Repo Markets: The Role of Financial Stress and Safe Asset Scarcity* is an ECB staff working paper. Focusing on repo specialness premia, using ISIN-specific transaction-by-transaction data of one-day maturity repos, the authors document a gradual shift from cash- to securities-driven transactions in euro area repo markets over the period 2010-2018. Compared to earlier studies focussing only on specific sub-periods or market segments the authors extend, illustrate, and validate evidence on financial frictions that are relevant in driving repo premia: controlling for a comprehensive range of bond-market specific characteristics, they show that repo premia have been systematically affected by fragmentation in the sovereign space, bank funding stress, and safe asset scarcity. These channels exhibit very strong country-specific differences, as also reflected by large discrepancies in country-specific interest rates on General Collateral.

Also on 31 January, the ESRB published a report on *CCP Interoperability Arrangements*. Four points are highlighted in the report's conclusions and policy recommendations section. First, in Europe, interoperability arrangements exist for a small number of assets and are used mainly for the clearing of securities transactions. Second, the ESRB sees a need to clarify the treatment of interoperability arrangements in the upcoming CCP recovery and resolution framework. Third, in addition, the ESRB suggests clarifying in EMIR whether interoperability arrangements for derivatives could be approved and implemented and, if so, for which product types and under what conditions. And, fourth, in the ESRB's view it is important to remove the legal uncertainty surrounding derivative links.

Published on 1 February, *To Ask or Not to Ask: Bank Capital Requirements and Loan Collateralization* is a Bank of England staff working paper, in which the authors study the impact of higher capital requirements on banks' decisions to grant collateralized rather than uncollateralized loans. They exploit the 2011 EBA capital exercise, a quasi-natural experiment that required a number of banks to increase their regulatory capital but not others. This experiment makes secured lending more attractive vis-à-vis unsecured lending for the affected banks as secured loans require less regulatory capital. Using a loan-level data set covering all corporate loans in Portugal, the authors identify a novel channel of higher capital requirements: relative to the control group, treated banks require loans to be collateralized more often after the shock, but less so for relationship borrowers.

Published on 11 February, *Central Counterparty Capitalization and Misaligned Incentives* is a BIS working paper, in which the author studies the incentives of a for-profit CCP with limited liability. Such a CCP faces a trade-off between fee income and counterparty credit risk. A better-capitalized CCP sets a higher collateral requirement to reduce potential default losses, even though it forgoes fee income by deterring potential traders. The author shows empirically that a 1% increase in CCP capital is associated with a 0.6% increase in required collateral. Limited liability, however, creates a wedge between the CCP's capital and collateral policy and the socially optimal solution to this trade-off. The optimal capital requirements should account for clearing fees.

Published on 13 February, *Money Markets, Collateral and Monetary Policy* is an ECB staff working paper. Noting that interbank money markets have been subject to substantial impairments in the recent decade, such as a decline in unsecured lending and substantial increases in haircuts on posted collateral, this paper seeks to understand the implications of these developments for the broader economy and monetary policy. To that end, the authors develop a novel general equilibrium model featuring heterogeneous banks, interbank markets for both secured and unsecured credit, and a central bank. The model features a number of occasionally binding constraints, and the interactions between these constraints – in particular leverage and liquidity constraints – are key in determining macroeconomic outcomes.

**The ESRB sees a need to clarify the treatment of interoperability arrangements in the upcoming CCP recovery and resolution framework.**

The authors find that both secured and unsecured money market frictions force banks to either divert resources into unproductive but liquid assets or to de-lever, which leads to less lending and output. If the liquidity constraint is very tight the leverage constraint may turn slack and, in this case, there are large declines in lending and output. The authors show how central bank policies which increase the size of the central bank balance sheet can attenuate this decline.

Published on 19 February, *Over-the-Counter Market Liquidity and Securities Lending* is a BIS working paper. The authors combine micro-data on corporate bond market trades with securities lending transactions and individual corporate bond holdings by US insurance companies. Applying a difference-in-differences empirical strategy, they show that the shutdown of AIG's securities lending program in 2008 caused a statistically and economically significant reduction in the market liquidity of corporate bonds predominantly held by AIG. They also show that an important mechanism behind the decrease in corporate bond liquidity was a shift towards relatively small trades among a greater number of dealers in the interdealer market.

Published on 14 March, *The Effect of Possible EU Diversification Requirements on the Risk of Banks' Sovereign Bond Portfolios* is an ESRB working paper, in which the authors evaluate the possible effects of introducing constraints on risk and diversification in the sovereign bond portfolios of the major European banks. Firstly, they capture the dependence structure of European countries' sovereign risks and identify the common factors driving European sovereign CDS spreads by means of an independent component analysis. They then analyse the risk and diversification in the sovereign bond portfolios of the largest European banks and discuss the role of home bias. Finally, they evaluate the effect of diversification requirements on the tail risk of sovereign bond portfolios and quantify the system-wide losses in the presence of fire-sales. Under their assumptions about how banks respond to the new requirements, demanding that banks modify their holdings to increase their portfolio diversification may mitigate fire-sale externalities, but may be ineffective in reducing portfolio risk, including tail risk.

Published on 27 March, *Does Liquidity Regulation Impede the Liquidity Profile of Collateral?* is an ECB staff working paper. The authors analyse the pledging behaviour of euro area banks during the introduction of the LCR. The LCR considers only a subset of central bank eligible assets and thereby offers banks an arbitrage opportunity to improve their regulatory ratio by altering their collateral pledging with the ECB. The authors use the existence of national liquidity requirements to proxy for banks' incentives to exploit this differential treatment of central bank eligible assets. Using security-level information on collateral pledged with the central bank, they find that banks without a preceding national liquidity requirement pledge more and less liquid collateral than banks with a preceding national liquidity requirement after the LCR introduction. They attribute the difference across banks to a preparation effect of the liquidity regulation on the national level.

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## Results of the 36th ICMA European Repo Market Survey

On 4 April 2019, ICMA's European Repo and Collateral Council (ERCC) published the 36th in its series of semi-annual surveys of the repo market in Europe. The Survey asked a sample of financial institutions in Europe for the value and breakdown of their repo contracts that were still outstanding at close of business on 5 December 2018. Replies were received from 58 offices of 54 financial groups, mainly banks. Returns were also made directly by the principal automatic repo trading systems (ATS) and tri-party repo agents in Europe.

The total value of the repo contracts outstanding on the books of the 58 institutions who participated in the latest survey was €7,739 billion, compared with €7,351 billion in June 2018. This represents an increase in the "headline" number since the last survey of 4.9%, and 6.3% year-on-year. Using a constant sample of banks, it is estimated that the market grew by 4.8% since June, and 5.9% year-on-year. The full survey is available on the ICMA website.

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# Green, Social and Sustainability Bond Markets





*by Nicholas Pfaff, Valérie Guillaumin, Peter Munro, Ozgur Altun and Berit Lindholdt-Lauridsen*

## Green, social and sustainability bond markets

The 2018 green, social and sustainability bond markets reached new records with combined issuance surpassing US$200 billon. As part of this, financial institutions established a leading role as issuers. Among regional developments, the performance of the Asia-Pacific region was remarkable, with green bond issuance growing 35%. Based on developments in the first quarter of 2019, green bond markets are on track to meet market forecasts for increased issuance in 2019, that broadly range between US$210 billion and US$250 billion.

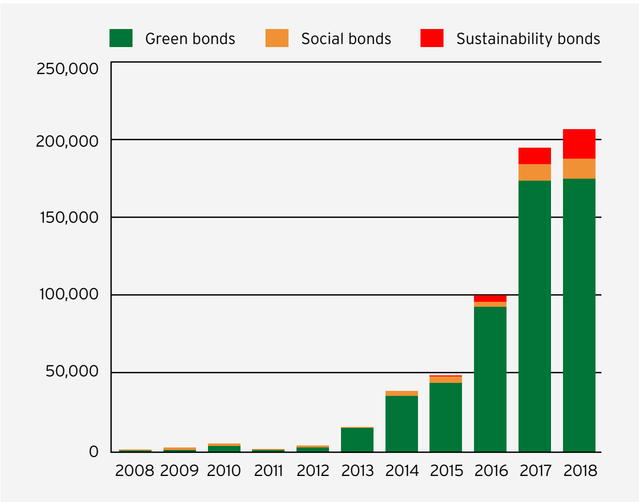
### *Overview of 2018*

The strongest area of growth in 2018 was in the sustainability segment, reaching US$18 billion (from US$10.3 billion in 2017), and referencing both green and social projects. Social bond markets also grew materially to US$13.9 billion (from US$11.2 billion in 2017, source: Environmental Finance), including the landmark inaugural corporate social bond issuance by Danone. However, the dominant source of issuance remained green bonds, reaching US$174.9 billion (Source: Environmental Finance). In cumulative terms, the outstanding green bond market exceeded US$500 billion in 2018. Such results are all the more remarkable in view of difficult general bond market conditions in late 2018.

In terms of issuer type, it was noteworthy that financial institutions took pole position, accounting for 30% of total issuance, an increase of almost 10 percentage points. There was also added momentum in sovereign issuance, helping to bring more benchmark liquidity to the green bond market, notably Belgium's €4.5 billion inaugural issuance, the largest issue in 2018, and Indonesia's inaugural issuance of sovereign green sukuk (US$1.25 billion). Other first-time sovereign issuers in 2018 were Ireland, Lithuania and the Seychelles, while France and Poland returned to the market at scale.

The modest expansion of green bond volumes masks a stronger diversification of issuance, with 204 new issuers in 2018 (146 in 2017, source CBI), and issuance from 44 countries (37 in 2017).

***Fig 1: Green, social and sustainability bond issuance volume – annual progression***

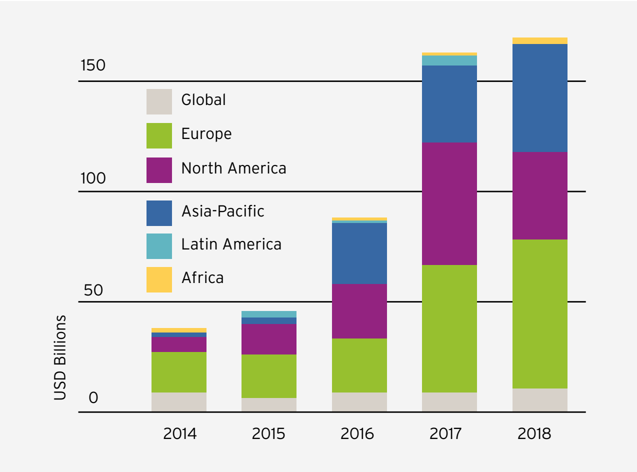



*Source: Environmental Finance*

From a currency perspective, EUR took the lead in 2018 (38%), influenced by European issuers accounting for over half of supply, closely followed by USD (34%), with CNY (14%) as the other major currency. This pattern was clearly correlated with geographic supply patterns.

Regionally, the performance of the Asia-Pacific region stood out, representing an increase of 35% to US$48 billion. Within this, the largest source remained China (US$31 billion; Source: CBI). China was the largest emerging market (EM) and the second largest global issuer after the US, representing over 70% of total EM issuance and 18% of global issuance. There was also strong activity in Asian EM countries ex-China, with ASEAN issuance more than doubling in the wake of the new ASEAN Green Bond Standards, launched in 2017 and based on the Green Bond Principles.

***Fig 2: Regional breakdown of green bond issuance***




*Source: CBI*

Looking at EM market innovation, a landmark development was the launch by IFC of the world's largest green bond fund, targeting green bonds issued by financial institutions in emerging markets, the "*Emerging Green One*" fund managed by Amundi (launched in early 2018). This is intended to create new markets by increasing not only demand, but also by supporting scaling up of supply by EM financial institutions. It is the first initiative to take such a holistic approach, by investing in emerging market green bonds, while also supporting supply, with a wide range of capacity building activities. An IFC-managed technical assistance programme will support development of green bond policies, providing training programmes for bankers and other stakeholders, and facilitating the adoption of the Green Bond Principles and international best practices in emerging markets. ICMA has supported this initiative by partnering with IFC to deliver innovative practitioner-oriented executive education, with an array of expert guest speakers and fresh sectoral insights on underlying assets, for example in real estate.

2018 was also characterised by the expansion of sustainable finance product innovation across capital markets, with sustainability criteria being incorporated into products such as loans – including launch of the Green Loan Principles in March. The trends have extended into mortgages, covered bonds and derivatives. With assets such as loans often being referenced in bonds aligned with the Principles, this broadens the foundations of the green, social and sustainability bond markets.

## *2019 developments*

The first months of 2019 have been promising for green bond markets. SSAs were very active, also providing liquidity at the long end. This included a return to market by the Republic of France (tap of Green OAT 2039 for €1.7 billion), the Republic of Indonesia (second green sukuk for US$750 million), and Belgium (tap for nearly €1 billion), and Poland's new dual tranche green bond (€1.5 billion 10 year and €500 million 30 year). The market is also keenly anticipating sovereign issuance expected from the Netherlands and Hong Kong. On sub-sovereign side, the importance of issuance linked to clean transport infrastructure is underlined by a remarkably large programme from Société du Grand Paris (Aa2/-/AA), Europe's largest live infrastructure project requiring capital of €35 billion (over a number of years), that launched a €2 billion 15 year issue.

MDBs have also started the year very actively, by issuing over US$2 billion in various currencies and thus bringing further liquidity into the market. Among the novelties was NIB's Nordic-Baltic Blue Bond (SEK2 billion, 5 year) aligned with the GBP, targeting projects for wastewater treatment, prevention of water pollution and water-related climate change adaptation. In corporate issuance, inaugural issuance of €1 billion by Telefonica represented the first by a telecommunication company.

The social and sustainability-themed bonds continue to flourish. Financial institutions from Korea issued over US$1 billion in two sustainability bonds, one of which was a Tier 2 transaction (Source: SocGen). Public sector issuers, such as Casa Depositi e Prestiti, NWB Bank, Comunidad de Madrid, and Caisse Française de Financement Local, together raised over €3 billion, while a dual tranche sustainability bond from Land NRW (Aa1/AA-/AAA) was remarkable in amount: €2.25 billion (Source: Environmental Finance).

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## European Action Plan on Sustainable Finance

There have been significant developments the past quarter relating to the ongoing implementation of the European Commission's Action Plan on Sustainable Finance and the work of the EU Technical Expert Group on Sustainable Finance (TEG) of which ICMA is a member. This has led to key consultations on topics such as the EU Taxonomy and now on the EU Green Bond Standard. There have also been important consultations from ESMA and the FCA, both related to the EU's sustainable finance agenda. ICMA has either responded or is in the process of responding to these consultations with the help of all its constituencies.

### *Closed consultations from the EU TEG on Sustainable Finance*

On 1 February 2019, ICMA responded to the EU consultation on *Climate Related Disclosures*. We welcomed the mapping of the recommendations of the TCFD against the EU Non-Financial Reporting Directive, and the identification of potential gaps. The proposals provide valuable guidance as to how companies, on a voluntary basis, can enhance their non-financial reporting. We noted and supported the fact that that the report stated that the recommended disclosures would remain voluntary and that there was no intention that they become mandatory. We also underlined the implementation difficulties for financial firms of the proposed disclosure requirements.

Later that month, primarily with the input of the Executive Committee of the Green Bond Principles (GBP), we responded to the *Usability of the Taxonomy*. We broadly welcomed the efforts to develop this sustainability classification system, but also underlined a number of issues including that:

(i) some of the proposed sustainability thresholds may be too ambitious (eg energy efficiency, green buildings);
(ii) there was no clear mechanism for geographic differentiation/adjustment;
(iii) an activity-based classification system will be challenging to apply to the complexity of many corporates businesses and to projects;
(iv) it does not easily accommodate the impact-based approach that prevails for green bonds and green finance;
(v) the thresholds for individual sectors should be reviewed from the perspective of achieved impact towards the climate goals of the Paris Agreement; and
(vi) a very significant portion of the existing green bond market could fail currently proposed key thresholds (mainly for energy efficiency improvements).

In subsequent communications within the TEG, we also emphasized that the Taxonomy may require interpretation by external reviewers and consultants for corporates and other organisations to feel comfortable applying its classifications, and these reviewers and consultants may need to have an ongoing dialogue with some form of Commission-supported and ongoing "Taxonomy Committee" to provide these services in a consistent and reliable manner.

### *Consultation on the EU Green Bond Standard*

The EU TEG released on 6 March 2019 an Interim Report on the EU GBS and launched a parallel consultation. A response to the consultation has been prepared with the GBP Executive Committee. The interim report contains 11 recommendations that are designed to establish and support the EU GBS and to respond especially to five perceived barriers to the further development of the green bond market in the EU and internationally, as well as a full draft of the proposed standard in an annex. These barriers are summarized in the table below alongside the related recommendations contained in the report.

## EU GBS: Identified Barriers and Proposals

| Barriers to green bond market development | How the proposed draft EU GBS seeks to address the barriers. |
|---|---|
| ***Absence of clear economic Incentives*** | **Demand and supply side measures and incentives to stimulate market growth:**<br>• Disclosure regime for institutional investors<br>• Credit enhancement for non-investment grade issuers<br>• Grant-scheme to offset the costs of external verification |
| ***Issuers concerns with reputational risks and green definitions*** | **Clarifying definitions, reporting requirements and roles:**<br>• Definition of green with EU Taxonomy (adapted to green bonds)<br>• Clarification of verifiers role and responsibilities<br>• Expanded and standardized reporting to clarify how issuers are expected to report on impact. |
| ***Complex and potentially costly external review procedures.*** | **Standardized verification process** focussing on the essential components.<br>**A grant scheme to offset the (initial) additional cost of external verification.** |
| ***Uncertainly on the type of assets and expenses that can be financed.*** | **The GBS broadens and defines the scope of eligible expenditures.** |
| ***Unclear expectations on the tracking of proceeds.*** | **Streamlining of tracking of proceeds.** |

At a high level, the report confirms the fundamental orientations and underlying principles of the EU GBS that had already been communicated to the market. These are that the EU GBS should be (i) a voluntary standard, (ii) aligned with EU Taxonomy, (iii) built on market best practices, (iv) be both a European and international standard, and (v) be accessible to existing green bond transactions and to all types of issuers. It is nonetheless important to note that the report states that after three years "possible recourse to legislation in support of the implementation of the EU GBS" could be considered. Our understanding is that this does not reflect any policy orientation of the Commission but could be considered pragmatically and for example in the context of introducing longer term incentives.

In the short term, the report does include recommendations for incentives to be introduced as soon as possible such as a grant scheme to cover verification costs and credit enhancement guarantees for sub-investment grade green bonds. More speculatively, the report also points to the possibility of tax and accounting proposals in support of green bond issuers that could be considered after further review.

Through the actual draft standard included in its annex, the report illustrates in some detail how the EU GBS builds on existing market practices while also proposing evolutions. At the same time, it introduces flexibility and gradualism on how the Taxonomy will be implemented. More specifically, the draft standard covers the following:

- Green projects are required to be aligned with the EU Taxonomy but it is acknowledged that it will be rolled out progressively over time and has been designed to identify a broader spectrum of sustainable activities rather than assets or projects. Specific language provides flexibility in its use. First, in areas not yet covered by the Taxonomy, market participants will be able to align with its "fundamentals": ie the EU environmental objectives, minimum social safeguards and "do no harm" criteria as long as the projects are validated on that basis by an EU accredited verifier. Second, they may also be validated with reference to the fundamentals of the Taxonomy in exceptional cases as a result of the location, the innovative nature or the complexity of proposed projects.

- Many issuers in the green bond market develop "frameworks" with the help of their underwriters to provide information especially on their future issues and on the type of projects that will be financed, but the EU GBS proposes a unified practice.

- The scope of eligible expenditures is broadened, taking into account capital and operational expenditures (capex and opex), working capital, public expenditures, as well as tangible and intangible assets.

- Reporting is expanded and standardised. As with the other components, the requirements of the proposed EU GBS are more specific than current market practice.

- Verification becomes mandatory and requires the accreditation of external reviewers. The EU GBS is a standard requiring verification which aligns it with leading best market practice. This is further exemplified by both pre-issuance verification focused on the green bond framework and post issuance verification covering the alignment of actual use of proceeds, as well as their actual or estimated impact.

Accreditation of external reviewers whether in relation to the interpretation of the Taxonomy or generally through the verification of alignment with the EU GBS will play a critical role. Acknowledging this, the Interim Report recommends that these organisations come under the scope of regulatory supervision, and specifically ESMA. As this would however require a period of 2-3 years for the necessary legislation to grant such powers to ESMA, a transitional, voluntary and market-led accreditation process is being proposed. It is important to note that ICMA may be asked to play a role in this initiative based on the

**The Interim Report illustrates how the EU GBS builds on existing market practices while also proposing evolutions.**

work already done with the GBP to promote best practices for external reviewers.

### *ESMA and FCA consultations on sustainability*

In addition to the flow from the EU TEG, there have been important consultations on sustainability issues from ESMA during the first quarter. Our replies to the ESMA consultations can be summarized as follows:

- The Primary Market Practices Committee (PMPC) and the Legal and Documentation Committee responded to ESMA's consultation paper on *Integrating Sustainability Risks and Factors in MiFID II* focusing on the need to clarify terminology and references to green labels and standards in the market while noting the absence of any concerns in the context of ICMA1/ICMA2.

- The Asset Management and Investors Council (AMIC) responded to ESMA's consultation paper on *Integrating Sustainability Risks and Factors in the UCITS Directive and AIFMD* expressing support for the high-level, principles-based approach for UCITS firms and AIFMs to integrate sustainability risks in their investment processes. It was underlined that sustainability risk should be treated as a separate (financial) risk distinct from (non-financial) impact risk.

- The Corporate Issuer Forum (CIF) responded on *Guidelines on Disclosure Requirements Applicable to Credit Ratings* welcoming efforts to improve the quality and consistency of ESG related disclosures in credit ratings and outlooks. The CIF agreed with the merits of positive identification where ESG factors are a key element behind a credit rating but cautioned about the challenge in isolating in all cases where a particular ESG element is, or importantly, is *not* a key underlying element.

Separately, ICMA also responded to the Financial Conduct Authority's *discussion paper on Climate Change and Green Finance*. Among others, we concurred with the view that climate change risks are likely to have a significant impact on financial markets and expressed support for voluntary disclosures as recommended by the Task Force for Climate-related Financial Disclosure (TCFD).

### *Other significant developments*

A political agreement was reached on 25 February by the European Parliament and EU Member States on a new generation of low-carbon benchmarks. This entailed a subsequent modification of the mandate given to the related working group of the EU TEG. The agreement envisaged two new categories of low-carbon benchmarks: a climate-transition benchmark and a specialised benchmark which brings investment portfolios in line with the Paris Agreement goal to limit the global temperature increase to 1.5˚above pre-industrial levels.

The two new categories are voluntary labels designed to orient the choice of investors who wish to adopt a climate-conscious investment strategy. The climate-transition benchmark will offer a low-carbon alternative to the commonly used benchmarks. The Paris-aligned benchmark will only comprise companies that can demonstrate that they are aligned with a 1.5˚ target. The challenge for the EU TEG will be to determine how easily the existing sustainable investment universe allows for the construction of benchmarks that fulfil these objectives.

Political agreement was also reached on 7 March by the European Parliament and EU Member States on new rules on disclosure requirements related to sustainable investments and sustainability risks. The agreed rules aim to strengthen and improve the disclosure of information by manufacturers of financial products and financial advisors towards end-investors. The new Regulation sets out how financial market participants and financial advisors must integrate environmental, social or governance (ESG) risks and opportunities in their processes, as part of their duty to act in the best interest of clients. It also sets uniform rules on how those financial market participants should inform investors about their compliance with the integration of ESG risks and opportunities.

The stated objective is to address information asymmetries on sustainability issues between end-investors and financial market participants or financial advisors. The Regulation covers (i) investment funds; (ii) insurance-based investment products; (iii) private and occupational pensions; (iv) individual portfolio management; and (v) both insurance and investment advice. Based on available information, the Regulation appears to put greater emphasis on ESG risks and due diligence rather than on sustainability opportunities, which was more the focus of the related recommendation on investor duties of the final report of the HLEG on sustainable finance to "encourage a greater focus on sustainability issues over the long term".

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The Green Bond Principles | The Social Bond Principles | The Sustainability Bond Guidelines

# Register Now

## 2019 Green Bond Principles and Social Bond Principles

Annual General Meeting & Conference

13 June 2019 I Frankfurt

ICMA International Capital Market Association | Green and Sustainable Finance Cluster Germany

The 2019 Green & Social Bond Principles AGM and Conference will be held in Frankfurt, Germany, on 13 June 2019. After a highly positive reception for the last annual meeting in Hong Kong, attracting well over 900 registrants, the AGM and Conference return to Europe at a time of important market and official sector initiatives on sustainable finance in the EU.

This year the meeting will be co-hosted by the Green and Sustainable Finance Cluster of Germany, and will be part of a "green & sustainable week" of events in Frankfurt, including meetings of GBP/SBP Executive Committee and working groups, a meeting of the Official Sector Contact Group and training led by ICMA and involving an array of leading market experts. There will also be a networking platform available for registrants in due course.

The Conference will be open to all professionals and officials interested in the future of this market, free of charge. It will address topical themes such as regulation, including green bond standards and green & social taxonomies/classifications, corporate issuer initiatives, impact reporting, growth markets, recently launched Sustainability-Linked Loan Principles, and important developments in the local German market.

We encourage early registration to secure a place at the Conference. Please see the event homepage to find out more or to register. Those interested in sponsorship opportunities for the Conference, which may be available via the German Cluster, are welcome to initially contact Allan Malvar, Managing Director responsible for Events at ICMA (allan.malvar@icmagroup.org), who can refer you to appropriate contacts at the Cluster.

The AGM itself is reserved for Members & Observers of the GBP/SBP (please see information on becoming a Member or Observer) and will feature an open discussion session with moderation by the GBP/SBP Executive Committee and the ICMA Secretariat, alongside formal points of business.

### Planning your calendar for the week

**Tuesday, 11 June:** Green & Social Bond Executive Course, hosted by Frankfurt School of Finance (Open to all market participants; course fee applies).

**Wednesday, 12 June:** Meeting of the Official Sector Contact Group (by invitation only).

**Thursday, 13 June:** Annual General Meeting - 8.30-11.30 am for Principles' Members & Observers only.

Conference and Reception: 11.30-19.30 (open to all market participants).

**Friday, 14 June:** Meetings of members of the Green Bond Principles and Social Bond Principles and members of the GBP & SBP Working Groups (by invitation only).

# Sustainable finance in Southeast Asia

*By Eugene Wong and Mushtaq Kapasi*

### Sustainable financing needs in Southeast Asia

The Southeast Asia region, comprising the 10 countries of ASEAN[1], would as a single entity be the fifth largest economy in the world, with a combined GDP of USD2.8 trillion in 2017[2]. Southeast Asia is poised to maintain its growth momentum, averaging 5.2% per year from 2018 to 2022 on robust domestic private spending and the implementation of planned infrastructure initiatives[3]. To sustain economic growth and infrastructure development in ASEAN, it has been estimated that USD210 billion per annum of investment is required between 2016-2030 for key infrastructure sectors and related areas taking into account climate mitigation and climate proofing costs[4].

Aside from generating economic activity and improving quality of life, infrastructure development also has significant implications on economic sustainability especially taking into account other external factors such as climate change, pollution, and other environmental factors which present new challenges to the growing economy.

The region's infrastructure and development needs combined with these environmental considerations represent opportunities for global investors seeking green and sustainable investments in the ASEAN region. Global investments with mandates to reduce greenhouse gas emissions and improve climate resilience can be channelled to fund the various green and infrastructure projects in ASEAN. Furthermore, innovative financial products including green, social and sustainable bonds can be used as tools to finance ASEAN infrastructure.

### The ASEAN Capital Market Forum (ACMF)

The ACMF, established in 2004 under the auspices of the ASEAN Finance Ministers, comprises capital market regulators from all ten ASEAN countries. Under the ACMF Vision 2025, ACMF endeavours to achieve an inter-connected, inclusive and resilient ASEAN capital market. The Chairmanship of ACMF rotates annually, and its current Chair is the Securities and Exchange Commission of Thailand, with the State Securities Commission of Viet Nam as Vice-Chair.

Over the years, there have been numerous capital market connectivity efforts launched by ACMF. Notable initiatives include the ASEAN Disclosure Standards and Streamlined Review Framework, which facilitates multi-jurisdiction offerings of equity and plain debt securities in ASEAN by streamlining the review process of offering documents by authorities. The ASEAN Collective Investment Schemes (CIS) Framework was developed to allow fund managers operating in a member country to offer CIS, such as unit trust funds, to retail investors in other member countries under a streamlined authorisation process. To foster professional mobility within the region, frameworks for cross-border movement of investment advisers and publication of research reports were recently launched, providing investors greater access to regional professional services.

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1. Association of Southeast Asian Nations, whose members are Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Viet Nam

2. GDP Ranking 2017, The World Bank

3. OECD Economic Outlook for Southeast Asia, China and India 2018

4. Meeting Asia's Infrastructure Needs, 2017 Asian Development Bank.

### ACMF Sustainable Finance Initiatives

ACMF views the imminent transition to an inclusive and sustainable economy with great importance and is guiding ASEAN nations towards this goal through its Sustainable Capital Markets agenda. In this regard, the ACMF saw the development of standards for the issuance of green, social and sustainability bonds as a key component of its agenda and pursued this through a working group led by Securities Commission Malaysia and Securities and Exchange Commission Philippines.

The launches of the ASEAN Green Bond Standards in 2017 followed by the ASEAN Social Bond Standards and ASEAN Sustainability Bond Standards in 2018 have resulted in the emergence of a new asset class in ASEAN. These ASEAN Standards were developed in alignment with the internationally recognised Green and Social Bond Principles and Sustainability Bond Guidelines which are widely used for the development of national guidelines or standards.

Employing the four core components advocated by the Principles (use of proceeds, process for project evaluation and selection, management of proceeds, and reporting), these standards were developed to encourage the practice of transparency and disclosure, and integrity in the development of the bond market.

The addition of key features in the suite of standards help to create a distinct ASEAN asset class for issuances complying with the standards. These additional features include:

- Eligible Issuers
- Ineligible Projects
- Continuous accessibility to information
- Encourage more frequent reporting
- External Review

### Conclusion

ACMF is currently focusing efforts to engage issuers and investors to build the supply and demand for sustainable investments in ASEAN. ACMF is organising roundtables and roadshows to promote the ASEAN Green, Social and Sustainable Bond Standards among regional issuers and attract global investors to channel investments to ASEAN sustainable asset classes.

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## ASEAN Green / Social / Sustainability Bonds / Sukuk: As of 11 March 2019

| No | Name of Issuer | Type of Project | Country of Issuance/ Origination | Currency | Programme/ Issuance Size (Million) | Amount Issued (Million) | Issue Date | Tenure (Years) | Bond/ Sukuk Listing | Green/ Social/ Sustainability Bond |
|---|---|---|---|---|---|---|---|---|---|---|
| 1. | PNB Merdeka Ventures Sdn Bhd | Green building | Malaysia | MYR | 2,000.00 | 690.00 | 29 Dec 2017 | 15 | Not listed | Green |
| 2. | Segi Astana Sdn Bhd | Green building | Malaysia | MYR | 415.00 | 415.00 | 8 Jan 2018 | 10 | Not listed | Green |
| 3. | Sindicatum Renewable Energy Co Pte Ltd | Renewable Energy | Singapore | INR | N.A. | 2,500.00 | 19 Jan 2018 | 5, 7 | London Stock Exchange | Green |
| 4. | UiTM Solar Power Sdn Bhd | Renewable Energy | Malaysia | MYR | 240.00 | 222.30 | 27 Apr 2018 | 18 | Not listed | Green |
| 5. | Sindicatum Renewable Energy Co Pte Ltd | Renewable Energy | Singapore | PHP | N.A. | 1,060.20 | 9 Aug 2018 | 10 | London Stock Exchange | Green |
| 6. | Kasikornbank Public Company Limited | Financing of green and social projects | Thailand | USD | 100.00 | 100.00 | 30 Oct 2018 | 5 | GreTai Securities Market | Sustainability |
| 7. | B. Grimm Power Public Company Limited | Renewable Energy | Thailand | BAHT | 5,000.00 | 5,000.00 | 20 Dec 2018 | 5,7 | Not listed | Green |
| 8. | Rizal Commercial Banking Corporation | Renewable energy, green buildings, clean transportation, energy efficiency, pollution prevention & control | Philippines | PHP | 15,000.00 | 15,000.00 | 1 Feb 2019 | 1.5 | Philippine Dealing & Exchange (PDEx) | Green |
| 9. | Pasukhas Green Assets Sdn Bhd | Environment & natural resource preservation, energy conservation, renewable energy and/or greenhouse gas emission reduction | Malaysia | MYR | 200.00 | 17.00 | 28 Feb 2019 | 20 | Not listed | Green |

## Information on ASEAN Green, Social and Sustainability Bond Standards

| | | | |
|---|---|---|---|
| **Complete Suite of ASEAN Standards** |   **ASEAN Green Bond Standards (GBS)** |   **ASEAN Social Bond Standards (SBS)** |   **ASEAN Sustainability Bond Standards (SUS)** |
| **Four components of ICMA Principles:** | The ASEAN GBS, SBS and SUS were developed in line with the four core components of ICMA's Green Bond Principles (GBP), Social Bond Principles (SBP) as well as Sustainability Bond Guidelines:<br>• the use of proceeds • process for project evaluation and selection<br>• management of proceeds • reporting | | |
| **Eligible Issuers** | The Issuer and issuance of the green, social and sustainability bonds must have a geographical or economic connection to the region. | | |
| **Ineligible Projects** | **Fossil fuel power generation projects**<br>The exclusion of **fossil fuel power generation projects** is to provide guidance to investors and Issuers as to what qualifies as green in order to mitigate greenwashing of projects and protect the ASEAN Green Bonds label. | **Alcohol, Gambling, Tobacco, Weaponry**<br>Projects which involve activities that pose a negative social impact related to **alcohol, gambling, tobacco** and **weaponry** are excluded. Issuers are also encouraged to develop a list of additional ineligible projects for the issuance of their ASEAN Social Bonds, if applicable. | The ineligible projects as defined under the ASEAN GBS and ASEAN SUS. |
| **Continuous accessibility to information** | The ASEAN GBS, ASEAN SBS and ASEAN SUS further set out how investors are to be given access to information continuously by requiring the Issuers to disclose information on use of proceeds, process for project evaluation and selection, and management of proceeds to investors in the issuance documentation, as well as ensuring such information is publicly accessible from a website designated by the Issuer throughout the tenor of the ASEAN Green, Social and Sustainability Bonds respectively. | | |
| **Encourage more frequent reporting** | In addition to annual reporting, Issuers are encouraged to provide more frequent periodic reporting which would increase transparency on the allocation of proceeds and investor confidence on the ASEAN Green, Social and Sustainability Bonds. | | |
| **External Review** | In line with ICMA's GBP, SBP and Sustainability Bond Guidelines, the appointment of an external reviewer is voluntary under the ASEAN GBS, ASEAN SBS and ASEAN SUS. However, considering the nascent stage of green, social and sustainability bond market development in ASEAN, the ASEAN Standards nonetheless require the external reviewers to have the relevant expertise and experience in the area which they are reviewing.<br>The external reviewers' credentials and scope of review conducted must be made publicly accessible from a website designated by the Issuer throughout the tenor of the ASEAN Green, Social and Sustainability Bonds. Such disclosure will contribute towards awareness creation and increased investor confidence. | | |

These standards have gained considerable traction for issuers across the region. To date, there have been 9 issuances from Malaysia, the Philippines, Singapore and Thailand carrying the ASEAN Green and Sustainability Bond labels[5]:

5. In addition, the Republic of Indonesia has issued a Sovereign Green Sukuk amounting to USD2 billion (USD1.25 billion issued in March 2018 and USD750 million issued in February 2019). This sukuk does not carry the formal ASEAN GBS label but has been designated by the second opinion as aligned with the ASEAN GBS.

 

# Asset Management

*by David Hiscock and Bogdan Pop*

## Covered bond legislation

On 26 February 2019, the EU Council and European Parliament agreed at a political level on the EU Covered Bond Directive and Regulation. This agreement was the culmination of months of intense negotiation over the proposals, which the European Commission had launched in March 2018. The texts must still be overseen by jurist linguists and will likely not be finalised until this summer when the new European Parliament is constituted.

The CBIC Secretariat has picked out a few significant areas of interest for covered bond investors.

On eligible assets the Directive splits covered bonds into two labels in Article 27: (1) "European Covered Bonds" which must follow all provisions of the Directive and (2) "European Covered Bonds (Premium)" which must follow all provisions of the Directive and fully the provisions of CRR Article 129.

The actual eligible assets article (Article 6) is now no longer split into "premium" and "ordinary" eligible assets, but only has one definition. Eligible assets for "European Covered Bonds must be:

- CRR Article 129(1)(a)-(g) assets; or
- "high-quality cover assets" that ensure the issuer has a claim for payment and secured by collateral (which includes physical assets); or
- loans to public undertakings.

With regard to investor information, the information to be disclosed to investors in Article 14 must be quarterly and must include the ISINs for all covered bond issues in the programme. The information also has to include information on any maturity extension triggers.

Regarding maturity extensions, Article 17(1)(a) explicitly states that the maturity can only be extended subject to objective triggers established in national law and not at the discretion of the issuer, a key issue for investors.

The Directive has also built into it a number of important reviews and reports:

- Two years after the Directive has to be transposed (see below for implementation details), the Commission has to submit a report to the European Parliament on an equivalence regime for third country issuers.
- Three years after the Directive has to be transposed, the Commission has to submit a more general report on a number of areas, including developments regarding the issue of covered bonds with extendable maturity structures.
- Two years after the Directive has to be transposed, the Commission must have ordered a study to be made (and consulted the EBA) which will contribute to a report and a possible legislative proposal on extendable maturity structures.
- Two years after the Directive has to be transposed, the Commission has to publish a report on the introduction of European Secured Notes (ESN) as a separate proposal.

Member States will have 18 months after publication in the *Official Journal* to comply with the Directive in national law. So, if the text is finalised by this summer, Member States would have to publish national measures by the end of 2020 or early 2021.

The CBIC will continue to follow the implementation process of the legislation and will continue to keep its members abreast of developments.

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## Leverage and systemic risk

IOSCO issued on 14 November 2018 a consultation paper on leverage in investment funds. The consultation paper was accompanied by a press release.

AMIC organised its response through the AMIC Fund Liquidity Working Group, in coordination with EFAMA. AMIC published its response on 1 February 2019.

AMIC stressed the general support from AMIC and its members for IOSCO's proposed two-step approach. More importantly, IOSCO's approach shows a welcome focus at each fund level on the potentially risky activities of asset managers as compared to an approach at management company level.

With regard to the first step of the leverage calculation models, AMIC recommends that the gross notional exposure (GNE) figure is combined with the net notional exposure (NNE) figure to filter potentially risky funds. AMIC also recommends the exclusion on a proportionality basis of all UCITS funds or failing that funds with less than US$ 100 million in assets under management or all funds with less than 300% net notional leverage exposure.

IOSCO also requested comments on an alternative to the GNE method: a so-called "adjusted" GNE method, which would account for delta adjustments and interest rate derivatives. While recognising theoretical advantages of an adjusted GNE, AMIC said that in practice it is not an appropriate metric to use.

AMIC also recommended that IOSCO align its framework with the CESR Guidelines on Risk Measurement and Calculation on Global Exposure and Counterparty Risks for UCITS (CESR/10-788).

AMIC views the second step as a framework for a more detailed risk-based analysis of risk in each jurisdiction, recognising that leverage as a concept is not synonymous with risk.

IOSCO will follow up with finalised guidance on the leverage calculation which individual jurisdictions must implement. AMIC will keep its members informed once the final IOSCO guidance is available.

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## Liquidity stress testing

On 8 January 2019, AMIC and EFAMA published a joint report on liquidity stress testing. The publication of the report was intended to inform AMIC and EFAMA views on ESMA's consultation on draft guidelines for liquidity stress testing which was issued on 5 February 2019.

The AMIC/EFAMA report highlights the role of stress tests as an important risk management tool which allows the fund manager to assess the impact of different market stresses at the portfolio level. Moreover, AMIC and EFAMA outline the long-standing standard practices in the fund industry and the existing comprehensive requirements foreseen by European and national laws. The report also finds that existing rules governing stress testing, notably the UCITS Directive and AIFMD, are already at an advanced level, and provide robust and appropriate liquidity risk management processes.

Based on the analysis, AMIC and EFAMA have pinpointed three key findings:

1. a principles-based approach on Liquidity Stress Testing (LST) governance and oversight is the optimal way forward;
2. proportionality is key for setting the right framework for LST, allowing the heterogeneous fund sector to tailor stress tests to the profile of the fund, their respective investors and the invested assets; and
3. given the existing robust EU regulatory framework, regional and national authorities should now focus on minimising operational impediments and facilitating asset managers' discharge of their liquidity risk management duties by ensuring that they can avail themselves of a broad range of liquidity management tools.

ESMA's consultation on this topic was widely expected following ESRB's February 2019 report on investment funds, which tasked ESMA with harmonising liquidity stress testing in Europe. AMIC's and EFAMA's joint report on liquidity stress testing was also largely prepared to position industry in advance of the consultation.

ESMA's draft guidelines are prepared at a high level and they are backed by explanatory considerations that help firms implement the requirements. AMIC's Fund Liquidity Working Group prepared a response to the consultation by the deadline of 1 April 2019.

AMIC is supportive of ESMA's overall principles-based approach. However, AMIC cautions that some implementation time is necessary, proposing 18 months from the time Member States inform ESMA whether they intend to comply with the guidelines or explain why not. AMIC also cautions against the use of the bid-ask spread as a liquidity measure for securities and warns that data on underlying investors make redemption stress testing difficult for asset managers.

ESMA is expected to issue its final liquidity stress testing guidelines in the summer of 2019.

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## UK Stewardship Code

The AMIC Corporate Governance Working Group has responded to the Financial Reporting Council's (FRC) consultation on a proposed revision to the UK Stewardship Code ("the Code") on 29 March 2019.

The proposed revised Code includes a new definition of stewardship which makes the creation of "sustainable value for beneficiaries, the economy and society" an essential aim of stewardship activity".

The consultation also focuses on a number of key points about the Code: the expansion in its scope to cover all asset classes; the inclusion of a strong ESG element; new annual reporting requirements for firms; and a new format similar to that of the UK Corporate Governance Code. According to the FRC, the revised Code takes account of the Shareholders Rights Directive II (SRD II), but sets a higher standard to which firms can voluntarily decide to sign up.

The AMIC response is broadly supportive of the FRC's revised Code, including the expansion in the scope of the Code to include all asset classes and the specific mention of bondholders, which was requested in the AMIC response to the FRC consultation on the UK Corporate Governance Code and Stewardship Code in February 2018.

There are two general areas where AMIC members asked for additional clarifications:

- While some of members supported the flexibility that the revised Code allows in terms of the new annual Activities and Outcomes Report, others said they would welcome more clarity around expectations, so as to avoid this becoming a "boilerplate report".
- Some members noted that the focus of the revised Code seemed to have switched towards value creation and reporting while de-emphasising the need to engage actively, which was at the core of the previous Code – if this was intentional, the FRC should state so explicitly.

The AMIC response also stressed the need to maintain flexibility in the revised Code to allow firms to implement it in a way which best fits their business models.

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## AMIC Council in Amsterdam

The latest AMIC Council took place on 7 March 2019 in Amsterdam, hosted by APG. The AMIC Council holds two plenary sessions annually to advise the Executive Committee of AMIC on priorities and to discuss current issues at biannual conferences. These meetings also provide excellent networking opportunities for the AMIC community.

The event started with a panel discussion on the future of sustainable finance in an evolving regulatory landscape. The panellists debated the green label, standardising sustainability metrics, the rise of green, social and sustainable bonds as well as their firm's approach to dealing with the new rules.

This was followed by a review of political changes in 2019 by Hans Hack, Senior Managing Director at FTI Consulting. He presented the perspective on Brexit as it is seen in Brussels; he highlighted the importance for the future of the EU of the EU Summit which will be held in Sibiu, Romania, on 9 May 2019; and he provided a detailed analysis of the shift in the balance of power within the European Parliament post-Brexit. He also gave a breakdown of the legislative files that the EU Presidency has closed, and those that it will not pursue, and the files that the industry should expect from the new European Commission following the elections to the European Parliament in May.

AMIC Chairman Robert Parker gave an overview of indicators of investment sentiment, including: the most crowded trades, tail risks, sector and asset allocation and overvalued markets. He also reviewed the performance in 2018 of asset classes and economic indicators, including monetary conditions, GDP forecasts, inflation trends, business and consumer confidence and economic surprises.

The second panel of the day discussed systemic risk and stress testing in investment funds. The panellists discussed the importance of liquidity stress testing, highlighted by a recent AMIC/EFAMA joint paper and ESMA consultation on the topic, and discussed the IOSCO consultation on leverage in investment funds.

The next AMIC conference will take place in London this autumn.

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# International Regulatory Digest

*by David Hiscock and Alexander Westphal*

## G20 financial regulatory reforms

In Basel on 14 January 2019, the BCBS's oversight body, the Group of Central Bank Governors and Heads of Supervision (GHOS), endorsed the BCBS's strategic priorities and work programme for 2019. This focuses on four key themes: (i) finalising ongoing policy reforms and pursuing targeted new policy initiatives where needed; (ii) evaluating and monitoring the impact of post-crisis reforms and assessing emerging risks; (iii) promoting strong supervision; and (iv) ensuring full, timely and consistent implementation of the BCBS's post-crisis reforms.

The GHOS also endorsed a set of revisions to the market risk framework, which will take effect as of 1 January 2022, concurrent with the implementation of the Basel III reforms endorsed by the GHOS in December 2017. These revisions, which enhance the market risk framework's design and calibration, were informed by the BCBS's QIS. Once implemented, the revised framework is estimated to result in a weighted average increase of about 22% in total market risk capital requirements relative to the Basel 2.5 framework (by contrast, the framework issued in 2016 would have resulted in a weighted average increase of about 40%). The share of risk-weighted assets (RWAs) attributable to market risk remains low, at around 5% of total RWAs. A description of the background, objectives and overall impact of the market risk framework is set out in an accompanying explanatory note.

On 17 January, the BCBS announced that it has completed a review, initiated in 2017, of its 2008 *Principles for Sound Liquidity Risk Management and Supervision*. The review confirmed that these Principles remain fit for purpose, concluding on the basis of information provided by each BCBS member jurisdiction that:

(i) all BCBS member jurisdictions have implemented these Principles through regulation, published guidance or supervisory practice;

(ii) the global liquidity standards introduced under Basel III – the LCR and NSFR – are important complements to these Principles; and as such, banks and supervisors should continue to heed the broader liquidity risk management considerations set out in these Principles; and

(iii) significant developments in financial markets since these Principles were published in 2008 are likely to have an important bearing on a bank's liquidity risk management considerations – these include the increasing digitisation of finance and payment systems and the broader

- growth of financial technology;
- a greater use of CCP clearing of derivatives and margining; and
- the increasing risk and magnitude of cyber-attacks.

The BCBS expects market participants to remain vigilant in their liquidity risk management; and, in line with these Principles, banks' risk management and supervisors' practices should be consistently and rigorously applied through the economic cycle, regardless of market liquidity conditions.

Meetings of G20 Finance Ministers' and Central Bank Governors' Deputies were held in Tokyo on 16-18 January. The opening remarks by Japanese Finance Minister Taro Aso, at the 18 January meeting, state that Japan's G20 Presidency will focus on the following three themes. First, the need to act on the risks and challenges to the global economy, including long-term structural issues such as global imbalances and ageing. Second, how the G20 could accelerate concrete actions to strengthen growth potential, including by discussing (i) investment in high-quality infrastructure and human capital; as well as (ii) how to ensure debt sustainability in low-income countries. And third, the economic and social structural changes stemming from technological innovation and globalization – specifically, including discussion of how to address issues regarding (i) the tax challenges of digitalization; (ii) financial market fragmentation; and (iii) and financial innovation.

Policy makers and stakeholders can do more to promote the development of robust and efficient capital markets, according to a report, published on 23 January, by the CGFS. *Establishing Viable Capital Markets* finds that large differences persist in the size of capital markets across advanced and emerging economies. Emerging-economy markets have been catching up with their more advanced peers, but the gap has not yet been closed. The analysis highlights the importance of macroeconomic stability, market autonomy, strong legal frameworks and effective regulatory regimes in supporting market development. Better disclosure standards, investor diversity, internationalisation, and deep hedging and funding markets, as well as efficient and robust market infrastructures, also play a key role.

On 4 February, the FSB published the *Global Monitoring Report on Non-Bank Financial Intermediation (NBFI) 2018*, which presents the results of the FSB's eighth annual monitoring exercise that assesses global trends and risks from NBFI. It covers data up to end-2017 from 29 jurisdictions, which together represent over 80% of global GDP, and focuses on those parts of NBFI that perform economic functions which may give rise to bank-like financial stability risks (ie the narrow measure of NBFI).

Among the main findings it is reported that collective investment vehicles (CIVs) with features that make them susceptible to runs (they invest mostly in credit assets and are involved in liquidity transformation) continued to drive the overall growth of the narrow measure in 2017, with CIV assets representing 71% of the narrow measure. Market intermediaries that depend on short-term funding or secured funding of client assets (mainly broker-dealers, which in some jurisdictions continue to employ significant leverage) grew by 5%, to make up 8% of the narrow measure. Also, investment funds and MMFs are the largest other financial institution (OFI) sub-sectors that provide credit to banks; and, in aggregate, banks and OFIs have become marginally more interconnected through credit and funding relationships in 2017, remaining around 2003-06 levels.

On 12 February, the FSB published for the first time its annual work programme, which describes its planned work and an indicative timetable of main publications for 2019. It reflects the FSB's continued pivot from post-crisis policy design to the implementation and evaluation of the effects of reforms and, in particular, vigilant monitoring to identify and address new and emerging risks to financial stability. It also describes new initiatives to reinforce stakeholder outreach. Main areas of work during the year are:

- Addressing new and emerging vulnerabilities in the financial system: the FSB will continue to scan the horizon to identify and assess emerging risks through regular discussion by its members of macro-financial developments, as well as through the biannual

**The BCBS expects market participants to remain vigilant in their liquidity risk management.**

Early Warning Exercise conducted jointly with the IMF. The FSB will also continue to assess the impact of evolving market structures and of technological innovation on global financial stability, including the resilience of financial markets in stress, the implications of the growth of non-bank financial intermediation and operational issues such as cyber risks.

- Finalising and operationalising post-crisis reforms: to reinforce the progress of reforms, the FSB is working with standard-setting bodies (SSBs) to complete work on a few final issues in the main reform areas.
- Implementation of reforms: this is not complete and it remains uneven. To maintain momentum and avoid complacency, the FSB, in collaboration with SSBs, will continue work on implementation monitoring through regular progress reports and peer reviews.
- Evaluating the effects of the reforms: the FSB will also take forward its programme to evaluate the effects of post-crisis reforms, assessing whether they are efficiently operating as intended and identifying and delivering adjustments where appropriate, while maintaining the agreed level of resilience.

Also on 12 February, a report, published on 12 February, by the IOSCO Assessment Committee (AC) indicates that the implementation of the IOSCO Secondary and Other Market Principles (SOMPs) is generally high across most of the 40 IOSCO member jurisdictions, from both emerging and advanced markets, which the AC reviewed (the scope of the review was limited to authorized exchanges and is based on information as of 15 October 2018).

The main objective of the review was to establish a global overview of the status of implementation of each of the five SOMPs by participating member jurisdictions, based on their self-assessments. The review identified gaps in implementation, particularly in nascent and emerging market jurisdictions, and also offered examples of good practices in implementing the SOMPs. The SOMPs form part of IOSCO's 38 Objectives and Principles of Securities Regulation, which provide core elements of an essential regulatory framework for securities regulations.

On 25 February, the FSB published a request for feedback from stakeholders, by 18 March, for its evaluation of the effects of financial regulatory reforms on the provision of financing to small and medium-sized enterprises. This evaluation forms part of a broader FSB examination of the effects of post-crisis reforms on financial intermediation. More details on the evaluation and a summary of the views expressed by some stakeholders can be found in a related note with the key takeaways of a roundtable held by the FSB on this topic, in December 2018.

The BCBS met in Basel, on 27-28 February, to discuss a range of policy and supervisory issues, and to take stock of its members' implementation of post-crisis reforms. The BCBS:

- took note of the implementation status of margin requirements for non-CCP cleared derivatives – a joint statement with IOSCO would be published in March to clarify certain implementation aspects of the margin requirements framework;
- reiterated its support for reforms of interest rate benchmarks and approved a work plan to look at the interactions with supervisory requirements;
- agreed to publish, in March, high-level supervisory expectations related to crypto-assets in light of the high degree of risks associated with such exposures;
- discussed the use of different practices among jurisdictions to proportionately apply the BCBS's global minimum prudential standards, and agreed to publish a summary of these practices in March;
- reviewed the follow-up reports and actions by member jurisdictions on the implementation of certain Basel III standards, which would be published in March;
- discussed its work programme for evaluating the impact of its post-crisis reforms, which includes planned evaluations related to cross-cutting policy issues, the countercyclical capital buffer framework and the G-SIBs framework; and
- discussed issues related to sovereign risk.

On 7 March, the Group of Governors and Heads of Supervision, the oversight body of the BCBS, appointed Pablo Hernández de Cos as the new BCBS Chairman, effective immediately. Pablo Hernández de Cos, the Governor of the Bank of Spain, succeeded Stefan Ingves, Governor of Sveriges Riksbank, who had chaired the Basel Committee since July 2011. As set out in the Committee's Charter, the Chair is appointed for a term of three years that can be renewed once. Subsequently, on 22 March, the BCBS announced the appointment of Carolyn Rogers as its next Secretary General, in succession to William Coen. Carolyn Rogers will assume her new responsibilities on 14 August 2019, for an initial term of three years, and will also serve as the Chair of the BCBS's Policy Development Group.

The Financial Stability Institute's 20th anniversary conference took place in Basel, on 12-13 March. Under the title of *A Cross-Sectoral Reflection on the Past, and Looking Ahead to the Future*, this conference featured three addresses complemented by six panel sessions: (i) the reconstructed supervisory framework – have we got the pieces right?; (ii) Basel I, II, III – evolution of global banking regulation; (iii) climate change and the financial system; (iv) people matters – governance of financial institutions; (v) technology – friend or foe?; and (iv) resolution and crisis management tools – how to ensure a smooth landing?

On 14 March, the BCBS published a report which summarises and analyses the results of the third-wave survey conducted by its Research Task Force on the role of multiple regulatory constraints in the Basel III framework. This latest survey (end-December 2017) retains the format of the end-December 2016 survey: each block of questions tests the impact of a regulatory instrument and provides an indication of the interaction among said instruments and the problems created by the growing complexity of the Basel III framework.

On 19 March, the BCBS published *Proportionality in Bank Regulation and Supervision – A Survey on Current Practices*. In brief, the majority of respondents to the survey currently apply proportionality measures in their jurisdictions. In most cases, such measures are applied to banks that represent a relatively small share of total banking assets in the relevant jurisdiction, although there is a fair degree of heterogeneity. Jurisdictions rely on a number of determinants in identifying proportionality thresholds/segments. In most cases, these indicators are coupled with supervisory judgment when determining the scope of banks subject to different requirements. Most jurisdictions apply some form of proportionality related to capital and liquidity requirements and the associated disclosure requirements. Most jurisdictions also apply a proportionate approach to their supervisory practices, including the intensity of on- and off-site examinations, requirements related to risk management controls and governance, and supervisory stress tests.

On 25 March, to enhance its effectiveness and the impact of its policy work on global securities markets, IOSCO published its first annual work programme. The Board agreed on five priority issues for its work in 2019, based on the conclusions of the *IOSCO Risk Outlook* and drawing on input from members and IOSCO policy committees. These identified priorities are: (i) crypto-assets; (ii) AI and machine learning; (iii) market fragmentation; (iv) passive investing and index providers; and (v) retail distribution and digitalization. Each of these priorities falls into one or more of five broad focus areas that were approved by the Board in late 2016 to guide IOSCO´s work. Alongside planned initiatives relating to these identified priorities, IOSCO will continue other work in 2019 within those same five focus areas. Among other things, this includes work on asset management, FinTech, cyber, financial benchmarks, sustainable finance, margin requirements, and financial market infrastructures.

Also on 25 March, the BCBS published overviews of follow-up actions taken or planned by member jurisdictions as of end-2018 to address deviations from the Basel standards identified as part of the BCBS's Regulatory Consistency Assessment Programme (RCAP). The follow-up actions pertain to assessments of risk-based capital and LCR regulations that were completed and published as of end-2017. Follow-up reports for assessments completed and published as of end-2018 will be published in 2020. These will cover, for the first time, assessments of BCBS members' regulations to implement the global standards for the NSFR and the framework for measuring and controlling large exposures. Previously, on 20 March, the latest Basel III monitoring results were published by the BCBS; and, alongside this, the EBA published two reports, which measure the impact of implementing the final Basel III reforms and monitor the current implementation of liquidity measures in the EU.

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## European financial regulatory reforms

For the first half of 2019, Romania has assumed the Presidency of the European Council. Its four stated priorities are to work for a Europe of convergence; a safer Europe; Europe, as a stronger global actor; and a Europe of common values. Within the Economic and Financial Affairs Council segment of its Presidency programme there is a section on strengthening EMU and the Banking Union and further developing CMU.

This will involve continuing the risk reduction process, including for NPLs, and supporting discussions on the use of the ESM as a backstop for the SRF, and on EDIS – in this process, the Presidency intends to ensure an open and transparent decision-making process at EU level, including with regard to countries which are not members of the euro area. Work on CMU proposals will be continued, in order to reduce differences in terms of jurisdiction to a minimum, to optimise opportunities for investors and to ensure SMEs' access to a wider range of financial resources. And, as part of the efforts to develop CMU, the Presidency will consider the implementation of the FinTech action plan and sustainable finance. A presentation of the Presidency work programme was made to ECON on 22 January.

On 4 February, ESMA published its 2019 *Regulatory Work Programme* (RWP), which provides an overview of ESMA's Single Rulebook work. It lists all the technical standards and technical advice that ESMA has been mandated to draft by the relevant legislation. The RWP has three annexes:

- annex I lists the mandates for technical standards and technical advice that are contained within legislative proposals – ESMA will begin work on those mandates once the legislation has been adopted;
- annex II gives the full references for the legislation currently in force that is referred to in this RWP; and
- annex III gives the full references for the legislative proposals that have not yet been adopted.

On 6 February, ESMA published its 2019 *Supervisory Convergence Work Programme*, setting out its workstreams to promote sound, efficient and consistent supervision across the EU. Built closely on those of 2018, the following priorities for supervisory convergence were identified for 2019:

- ensuring supervisory convergence in the context of the UK's decision to withdraw from the EU;
- making data and its use more robust and consistent by developing and further clarifying reporting methodologies and providing guidance to ensure complete and high-quality data;
- driving forward consistency in the application of the Markets in Financial Instruments Directive and Regulation (MiFID II/R) and reaching a common understanding on arising supervisory challenges;
- safeguarding the free movement of services in the EU through adequate investor protection in the context of cross-border provision of services; and
- fostering supervisory convergence in the field of financial innovation.

On 7 February, ESMA published its *Risk Assessment Work Programme*, providing an overview of the analytical, research, data and statistical activities that ESMA will carry out in 2019. ESMA's 2019 risk assessment agenda is focused on further developing ESMA's proprietary data sources and their analytical exploitation. Elements include:

- market data: as market data collected under its AIFMD, MiFID and EMIR mandates and others becomes available, ESMA is (in cooperation with the NCAs) finalising the framework for processing, management and analysis;
- risk monitoring: ESMA will enhance its risk monitoring capacities, generating market statistics as well as risk indicators and metrics based on new proprietary data. Most importantly for 2019, ESMA will complement its ongoing market monitoring reports by publishing an annual statistical report series – this will cover EU derivatives markets (EMIR data); EU alternative investment funds (AIFMD data); the cost and past performance of long-term retail investment products (UCITS, retail AIFs and structured retail products); and the first annual statistical report on MiFID II data;
- analysis: ESMA will continue to conduct in-depth analysis around key topics, including market and fund liquidity, fund leverage, and the impact of innovation especially in the areas of market infrastructures and investment advice; and
- impact assessment: ESMA is set to continue its impact assessment activities, complementing the RWP, and will (with the NCAs) improve its stress testing work to facilitate more sophisticated future EU-wide tests on CCPs as well as developing its approach to investment fund stress testing.

On 15 February, it was announced that EU ambassadors had endorsed an agreement reached between the Romanian Presidency and the Parliament on a set of revised rules aimed at reducing risks in the EU banking sector. Among the core measures agreed, the package enhances the framework for bank resolution. It requires G-SIIs to have more loss-absorbing and recapitalisation capacity by setting the requirements as regards the amount and quality of own funds and eligible liabilities (MREL) to ensure an effective and orderly bail-in process. It also provides provisional safeguards and possible additional actions for resolution authorities.

The package also strengthens 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. In addition, the banking package contains measures to improve banks' lending capacity and to facilitate a greater role for banks in the capital markets, such as enhancing the capacity of banks to lend to SMEs and to fund infrastructure projects. The banking 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. Following legal linguistic revision of the text, the Parliament and Council will be called on to adopt the proposed regulation at first reading.

On 19 February, ESMA published its 2019 *Direct Supervision Work Programme*, which details the main areas of focus for the upcoming year for its supervision of TRs, CRAs, and the monitoring of third-country market infrastructures such as third-country CCPs (TC-CCPs) and third-country CSDs (TC-CSDs). ESMA currently directly supervises eight TRs and 27 CRAs and carries responsibility for four certified CRAs and 32 TC-CCPs. For CRAs and TRs in the EU, ESMA uses a risk-based approach to establish its annual Supervision Work Programme and for 2019, the supervisory priorities will include:

- TR data quality and access by public authorities; and TR business

**On 10 out of 13 legislative CMU proposals tabled by the Commission, agreements have been reached with three already finally adopted.**

continuity planning, IT process and system reliability, and information security function;

- CRA portfolio risk and quality of the rating process; and CRA Cybersecurity; and
- recognition of UK CCPs in a no-deal Brexit scenario; and assessing the pending applications for recognition as TC-CCPs and TC-CSDs, including risk monitoring.

In addition, there are areas where common issues exist across TRs and CRAs on which ESMA will perform further work including Brexit, fees charged by CRAs and TRs, the effectiveness of internal control systems, and the use of new technologies.

Separately, on 5 February, EIOPA published an updated work programme for 2019, highlighting and specifying its activities and tasks for the coming year, within the framework of a multiannual work programme 2019-2021. In relation to its cross-cutting themes of InsurTech and Sustainable Finance, EIOPA's 2019 priorities relate to fragmentation of the value chain and impact on business models; big data; and cyber risks. EIOPA's priorities for 2019 are also elaborated in relation to its four strategic business objectives: (i) driving forward conduct of business regulation and supervision; (ii) leading convergence towards high-quality prudential supervision throughout the EU; (iii) strengthening the financial stability of the insurance and occupational pensions sectors; and (iv) delivering EIOPA's mandate effectively and efficiently.

On 26 February, the European Commission welcomed the political agreement reached by the European Parliament and EU Member States on more proportionate and effective prudential rules for investment firms. The investment firms review divides investment firms into three categories: (i) large firms, which will remain under the scope of existing prudential rules and with the most systemic ones now being brought under the same supervisory regime as significant credit institutions; (ii) other firms, which will be subject to a revised rulebook, taking their specific risks into account; and (iii) the smallest firms, which will benefit from simpler and more streamlined requirements. Targeted changes are also introduced under which providers based in non-EU countries can offer their services to EU companies and clients. Further technical work will follow this political agreement so that the European Parliament and Council can formally adopt the final texts under this legislature.

On 15 March, ahead of the Spring European Council meeting on 21-22 March, the European Commission reported on progress achieved in building a single market for capital, including as regards sustainable finance, and called on EU leaders to keep up the political engagement to lay down the foundation of the CMU. The Commission has delivered all the measures it has committed to in the CMU action plan of September 2015 and in the mid-term review of June 2017, contributing to laying key building blocks of the CMU.

On 10 out of 13 legislative CMU proposals tabled by the Commission, agreements have been reached with three already finally adopted. In addition, on two out of three Commission proposals on sustainable finance agreements have been reached. Moreover, the Commission adopted two delegated regulations containing most implementing measures to finalise the prospectus reform, another important milestone towards the completion of the CMU. Future action will need to reflect the impact on capital markets of the UK's departure from the EU and other short or medium-term economic and societal challenges, including fundamental rapid changes arising from the decarbonisation of the economy and the changing climate, and technological developments. Vice-President Dombrovskis made a public statement on this CMU progress report and an associated set of questions and answers were published.

On 21 March, it was announced that the Presidency and the Parliament have agreed on the first fundamental review of the tasks, powers, governance and funding of the ESAs and the ESRB, so as to adapt the authorities to the changed context in which they operate. The agreed text improves the existing system for supervisory convergence in order to make the process more efficient, coherent and transparent. It builds on existing tools, such as peer reviews, guidelines, Q&A while introducing new ones, for example the establishment of coordination groups at EU level. The agreement also reviews the ESAs' governance structure, maintaining the principle that decisions have to be taken by the Board of Supervisors and ensuring a key role for NCAs within the

ESAs' governance structure. In parallel, the role and powers of the Chairperson are reinforced.

As regards the ESAs' funding scheme, the final text preserves the existing system of contributions coming partly from the EU budget and partly from NCAs, while adding the possibility of any voluntary contribution from Member States or observers. The reform also reviews the powers of each of the three ESAs, with the agreement giving ESMA direct supervision powers over third country critical benchmark administrators, as well as in respect to data reporting service providers (except for small local ones). Finally, the reform strengthens the role and powers of the EBA as regards AML supervision. Pending technical finalisation of the text, the provisional agreement will be submitted for endorsement to EU ambassadors; and both the Parliament and Council will be called on to adopt the proposed regulation at first reading. The Commission welcomed this agreement.

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## Macroprudential risk

On 8 January 2019, the EBA published its *Risk Dashboard*, which summarises the main risks and vulnerabilities in the EU banking sector using quantitative risk indicators. Together with the Risk Dashboard, the EBA published the results of its *Risk Assessment Questionnaire* (RAQ), which includes the opinions of banks and market analysts on the risk outlook collected in autumn 2018. In the third quarter of 2018, the Dashboard confirms improvements in both asset quality and capital ratios, while profitability remains subdued. Regarding funding, the RAQ results show that two out of three responding banks plan to increase the issuance of MREL eligible instruments. However, around 50% of the banks consider challenges around pricing as the main constraint for such issuances. Analysts are confident that banks will be able to issue BRRD / MREL / TLAC eligible instruments and also agree that the costs for such issuances will rise in the upcoming period.

Published on 11 January, *Bank Profitability and Financial Stability* is an IMF staff working paper, in which the authors analyze the subject from both theoretical and empirical perspectives. Their results reveal that profitability is negatively associated with both a bank's contribution to systemic risk and its idiosyncratic risk, and an over-reliance on non-interest income, wholesale funding and leverage is associated with higher risks. Low competition is associated with low idiosyncratic risk but a high contribution to systemic risk. Lastly, the problem loans ratio and the cost-to-income ratio are found to be key factors that influence bank profitability. The paper's findings suggest that policy makers should strive to better understand the source of bank profitability, especially where there is an over-reliance on market-based non-interest income, leverage, and wholesale funding.

Published on 16 January, *Leaning Against the Wind: Macroprudential Policy and the Financial Cycle* is an ECB staff working paper, which considers whether monetary policy should lean against financial stability risks. The authors contribute to the debate about leaning against the wind (LAW) along three lines. First, they evaluate the cost and benefits of LAW and find that the costs outweigh the benefits. Second, they extend their evaluated framework to address a critique that it does not consider the lower frequency financial cycle. And, third, they use this extended framework to assess the costs and benefits of monetary and macroprudential policy. They find that macroprudential policy has net marginal benefits in addressing risks to financial stability in the euro area, whereas monetary policy has net marginal costs. This would suggest that an active use of macroprudential policies targeting financial stability risks would alleviate the burden on monetary policy to lean against the wind.

Published on 17 January, *Global Banking, Financial Spillovers, and Macroprudential Policy Coordination* is a BIS working paper, in which the gains from international macroprudential policy coordination are studied in a two-region, core-periphery macroeconomic model with imperfect financial integration and cross-border banking. Financial frictions occur at two levels: between firms and banks in each region, and between periphery banks and a global bank in the core region. Macroprudential regulation takes the form of a countercyclical tax on bank loans to domestic capital goods producers, which responds to real credit growth and is subject to a cost in terms of welfare. Numerical experiments, based on a parameterized version of the model, show that the welfare gains from macroprudential policy coordination are positive, albeit not large, for the world economy. In addition, these gains tend to increase with the degree of international financial integration. However, depending on the origin of financial shocks, they can also be highly asymmetric across regions.

On 28 January, Mario Draghi, in his capacity as Chair of the ESRB, addressed the Committee on Economic and Monetary Affairs of the European Parliament. He used this opportunity to reflect on what the ESRB had achieved in the macroprudential policy area, highlight the main findings of its report on macroprudential approaches to non-performing loans, which was published that day, and discuss the challenges that lie ahead. In the latter regard, given that a growing share of credit intermediation is conducted by non-bank financial institutions, he said that

Europe should equip macroprudential authorities with the appropriate tools to act in case existing risks migrate outside the banking sector or new risks emerge. He also reported that another challenge ahead is related to monitoring the financial system, which requires the ESRB to have access to high-quality, detailed and granular transactions data.

On 31 January, EIOPA published its updated *Risk Dashboard* based on the third quarter 2018 data. The results of the third quarter 2018 show that the risk exposure of the EU insurance sector remains stable overall. Given the ongoing reduction in the accommodative stance of monetary policy, macro risks stand at medium level, however, further downward revisions of economic growth forecasts remain a concern going forward. Credit and market risks continue at medium level, with CDS spreads for corporate bonds as well as equity market volatility increasing since September. Insurance risks also increased, following the impact on (re)insurers loss ratios of the natural catastrophes observed in Q3 2018, but remain at low level.

Published on 5 February, *An Examination of Initial Experience with the Global Systemically Important Bank Framework* is a BCBS working paper. Several issues are examined by the authors. First, they investigate whether G-SIBs and non-G-SIBs have behaved differently since the implementation of the G-SIB framework and if observed differences in behaviour are in accordance with the framework's aims. Next, they ask whether there are regional differences in the behaviour of G-SIBs and non-G-SIBs.

The analysis reveals that G-SIBs and non-G-SIBs behave differently; however, both groups are heterogeneous, so that the indicator outcomes are often highly influenced by a few banks. Nevertheless, most G-SIBs have reduced their G-SIB scores during the period assessed, changing their balance sheets in ways that are consistent with the G-SIB framework's aims. In contrast, non-G-SIBs have increased their relative G-SIB scores during the same period. Finally, the regional analysis indicates that trends in banks' G-SIB indicators, and the indicators that contribute most to the final G-SIB score, are heterogeneous across countries and regions. While G-SIBs from the euro area, the UK and the US have reduced their systemic importance for most indicators, Chinese and Japanese G-SIBs have shown relatively positive growth rates for all indicators, and particularly high ones for indicators in the substitutability category.

Published on 14 February, *Anticipating the Bust: A New Cyclical Systemic Risk Indicator to Assess the Likelihood and Severity of Financial Crises*, is an ECB occasional paper, which presents a tractable, transparent and broad-based domestic cyclical systemic risk indicator (d-SRI) that captures risks stemming from domestic credit, real estate markets, asset prices, and external imbalances. The d-SRI increases on average several years before the onset of systemic financial crises, and its early warning properties for euro area countries are superior to those of the total credit-to-GDP gap.

In addition, the level of the d-SRI around the start of financial crises is highly correlated with measures of subsequent crisis severity, such as GDP declines. Model estimates suggest that the d-SRI has significant predictive power for large declines in real GDP growth three to four years down the line, as it precedes shifts in the entire distribution of future real GDP growth and especially of its left tail. The d-SRI therefore provides useful information about both the probability and the likely cost of systemic financial crises many years in advance. Given its timely signals, the d-SRI is a useful analytical tool for macroprudential policy makers.

Published on 22 February, *Macroprudential Policy with Capital Buffers* is a BIS working paper, which studies optimal bank capital requirements in a model of endogenous bank funding conditions. The author finds that requirements should be higher during good times such that a macroprudential buffer is provided. However, whether banks can use buffers to maintain lending during a financial crisis depends on the capital requirement during the subsequent recovery. The reason is that a high requirement during the recovery lowers bank shareholder value during the crisis and thus creates funding-market pressure to use buffers for deleveraging rather than for maintaining lending. Therefore, buffers are useful if banks are not required to rebuild them quickly.

On 28 February, ESMA published its latest *Trends, Risks, and Vulnerabilities (TRV) Report (No 1. 2019)*, noting that uncertainty related to Brexit, amid weakening growth prospects, global trade tensions, and reduced global monetary policy stimulus have contributed to market risk remaining very high. The fourth quarter of 2018 saw increasing volatility on equity and sovereign bond markets, a decrease in equity prices, continued repricing on corporate and sovereign bond markets, and regional developments leading to localised sell-offs and increased short-selling activity.

Overall risk levels for EU financial markets remained stable but at high levels for most risk categories, particularly liquidity, market contagion and credit risk. Securities markets experienced several episodes of short-term volatility, and equity markets suffered sharp declines from October onwards, erasing all the gains made in the first half of 2018. Going forward, EU financial markets can be expected to become increasingly sensitive to mounting political and economic uncertainty, with concerns over a no-deal Brexit weighing on economic

**The BIS has launched a public, online and interactive repository of studies on the effects of financial regulations, called FRAME.**

and market expectations. Articles in the vulnerabilities section of the TRV also look in more detail at RegTech and SupTech; retail AIFs; the double volume cap mechanism; and new stress-testing requirements for EU MMFs.

Published on 4 March, *What Drives Sovereign Debt Portfolios of Banks in a Crisis Context?* is an ESRB working paper, in which the authors study determinants of sovereign portfolios of Spanish banks over a long time-span, starting in 2008. Their findings challenge the view that banks engaged in moral hazard strategies to exploit the regulatory treatment of sovereign exposures. In particular, they show that being a weakly capitalized bank is not related to higher holdings of domestic sovereign debt. While a strong link is present between central bank liquidity support and sovereign holdings, opportunistic strategies or reach-for-yield behaviour appear to be limited to the non-domestic sovereign portfolio of well-capitalized banks, which might have taken advantage of their higher risk-bearing capacity to gain exposure (via central bank liquidity) to the set of riskier sovereign bonds. Furthermore, they document that financial fragmentation in EMU markets has played a key role in reshaping sovereign portfolios of banks. Overall, the authors' results have important implications for the ongoing discussion on the optimal design of the risk-weighted capital framework of banks.

On 5 March, the BIS published its latest quarterly review, reporting that shifting macroeconomic prospects in major economies, and their implications for monetary policy, dominated market developments at the end of 2018 and in the early months of 2019. This review also looks at the reliance of emerging market economies on foreign bank credit; examines market stress around the turn of the year; and analyses investment mandates and the risk of fire sales in the case of BBB bonds held by mutual funds. There are also four special features: (i) beyond LIBOR: a primer on the new benchmark rates; (ii) impact of financial regulations: insights from an online repository of studies; (iii) following the imprint of the ECB's asset purchase programme on global bond and deposit flows; and (iv) the zero lower bound, forward guidance and how markets respond to news.

As announced in this BIS quarterly review, the BIS has launched a public, online and interactive repository of studies on the effects of financial regulations, called FRAME. The purpose of this repository is to keep track of, organise, standardise and disseminate the latest findings. FRAME currently covers 83 studies and 139 quantitative impact estimates from 15 countries or groups of countries, offering a new and comprehensive perspective on what the literature has been able to document to date, and where gaps exist. They observe a high degree of heterogeneity across impact estimates, notably in terms of the effects of capital regulation on loan growth: while on average the estimated effect is that more capital leads to more lending, there are large differences across studies. A meta-analysis shows that an important driver of these differences is whether the underlying study incorporates second-round effects.

Also on 5 March, the Bank of England published the record of the Financial Policy Committee meeting held on 26 February. Among other things, this reports that the FPC reviewed developments since its meetings on 20 and 27 November and judged that: "the core of the UK financial system, including banks, dealers and insurance companies, is resilient to, and prepared for, the wide range of risks it could face, including a worst-case disorderly Brexit." Furthermore, "most risks to UK financial stability that could arise from disruption to cross-border financial services in a no-deal Brexit have been mitigated." However, "some disruption to cross-border services is possible and, in the absence of other actions by EU authorities, some potential risks to financial stability remain." Additionally, "financial stability is not the same as market stability. Significant market volatility is to be expected in a disorderly Brexit. However, markets have proved able to function effectively through volatile periods."

Published on 18 March, *Effectiveness of Policy and Regulation in European Sovereign Credit Risk Markets: A Network Analysis* is an ESRB research paper. The authors study the impact of changes in regulations and policy interventions on systemic risk among European sovereigns measured as volatility spillovers in respective credit risk markets. Their unique intraday CDS dataset allows for precise measurement of the effectiveness of these events in a network setting. In particular, it allows discerning interventions which entail significant changes in network cross-effects with appropriate bootstrap confidence intervals. They show that it was mainly regulatory changes, with the ban of trading naked sovereign CDS in 2012 as well as the new ISDA regulations in 2014, which were most effective in reducing systemic risk. In comparison, they find that the effect of policy interventions was minor and generally not sustainable. In particular, they only had a significant impact when implemented for the first time and when targeting more than one country. For the volatility spillover channels, they generally find balanced networks with no fragmentation over time.

On 19 March, the EBA updated the 2018 list of Other Systemically Important Institutions (O-SIIs) in the EU. O-SIIs have been identified by the relevant EU authorities according to harmonised criteria provided by the EBA Guidelines, which define the size, importance, complexity (or cross-border activities) and interconnectedness as the criteria to identify O-SIIs. This updated list also reflects the additional capital buffers that the relevant authorities have set for the identified O-SIIs. For the first time, the list of O-SIIs is made available in a user-friendly visualisation tool format, including the information on O-SII buffers assigned to identify institutions across the EU.

Published on 26 March, *Interactions Between Monetary and Macroprudential Policies* is an ECB research bulletin, which considers whether monetary policy should be concerned with financial stability or whether financial supervisory and regulatory policies suffice to achieve this goal. To address these questions, the author has developed a tractable monetary model in which systemic risk and economic activity both depend on financial conditions. He shows that there are benefits from using monetary policy (ie interest rate policies) to enhance financial stability. These benefits are quantitatively moderate, however, and partly offset by costs in terms of inflation variability.

On 27 March, the ECB published the seventh issue of its *Macroprudential Bulletin*. This issue focuses on four areas in particular. The first article investigates whether the euro area banking system is more resilient ten years after the global financial crisis. The second reports the results of a macroprudential stress-test that finds that the euro area banking system would be resilient to a deep simultaneous recession in global economies combined with large falls in asset prices in 2018-2020. The third focuses on financial stability risks stemming from the residential real estate market. And, the fourth presents a review of the strategic choices regarding the timing and calibration of the countercyclical capital buffer in the euro area, finding commonalities as well as country specificities. As in previous issues, there is also an overview of macroprudential policy measures that are currently applicable in euro area countries.

On 28 March, the ESRB reported on the 33rd regular meeting of its General Board, held on 21 March. In this meeting, the General Board highlighted the repricing of risk premia in global financial markets and the deterioration of the economic outlook as the main risks to financial stability in the EU. The General Board continued to discuss the results of the ongoing monitoring of developments in the EU derivatives markets and exchanged views on the major trends in macroprudential policy in the EU in 2018. The General Board also considered two reports, which will be published in the coming months, prepared by the ESRB Advisory Scientific Committee: the first discusses the contribution of regulatory complexity to systemic risk and considers some principles to enhance current regulation; and the second discusses the main channels through which the ETF market may affect systemic risk. Additionally, the General Board amended the ESRB Recommendation on closing real estate data gaps and approved a set of adverse scenarios prepared jointly by ECB staff and the ESRB Task Force on Stress Testing.

Alongside this report, the ESRB released the 27th issue of its *Risk Dashboard*. This records that risks to EU financial stability remain a concern, although market-based indicators of systemic stress in the EU slightly declined over the past quarter. Economic growth in the EU moderated further and debt levels remain elevated across countries and sectors in the EU, although most countries deleveraged somewhat in the recent years. Bank profitability in the EU showed a slight improvement in the fourth quarter of 2018 and banking sector resilience continued to strengthen in the second half of 2018. Also, after no significant growth in 2017, total assets of EU investment funds and OFIs increased in 2018 at a faster pace than the banking sector and new data sources allowed for a reduction in the OFI residual in 2018. Finally, the overall picture drawn by the CCP indicators has remained broadly stable, notwithstanding differences between CCPs.

Published on 29 March, *Macroprudential Policy in a Monetary Union with Cross-Border Banking* is an ECB staff working paper. The authors analyse the interaction between monetary and macroprudential policies in the euro area by means of a two-country DSGE model with financial frictions and cross-border spillover effects. They calibrate the model for the four largest euro area countries, with particular attention to the calibration of cross-country financial and trade linkages and country specific banking sector characteristics. They find that countercyclical macroprudential interventions are supportive of monetary policy conduct through the cycle. This complementarity is significantly reinforced when there are asymmetric financial cycles across the monetary union, which provides a case for targeted country-specific macroprudential policies to help alleviate the burden on monetary policy. At the same time, their findings point to the importance of taking into account cross-border spillover effects of macroprudential measures within the Monetary Union.

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## Interest rate benchmarks

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

On 7 March 2019, ESMA published a statement on its approach to the application of some key MiFID II/MiFIR and EU BMR provisions should the UK leave the EU under a no-deal Brexit. Regarding the EU BMR this sets out details regarding the ESMA register of administrators and third country benchmarks. Subsequently, on 13 March, the FCA published a statement on various MiFID obligations and the BMR if the UK leaves the EU without an implementation period. This highlights that the FCA will be setting up a UK public register of benchmarks and administrators authorised in the UK. In a further statement, on 22 March, the FCA then expanded on details of its plan to introduce a UK Benchmarks Register.

Previously, on 7 January 2019, EMMI announced Banca Monte dei Paschi di Siena's withdrawal from the panel of banks contributing to the EURIBOR benchmark, with immediate effect. Following this, the panel of banks contributing to EURIBOR consists of 19 banks.

On 21 January, the €RFR WG published a paper, *Guiding Principles for Fallback Provisions in New Contracts for Euro-Denominated Cash Products*. This paper offers an overview of the legal frameworks and market practices applicable to cash products, such as mortgages, loans and bonds, that reference EURIBOR and EONIA, with a specific focus on fallback clauses. It is important that market participants prepare for the transition to RFRs and the paper proposes a set of guiding principles promoting the use of effective fallback provisions in new contracts for euro-denominated cash products. In the course of 2019, the €RFR WG intends to recommend more detailed fallback language to be used in legacy and new euro-denominated contracts.

The Alternative Reference Rates Committee (ARRC) is publishing frequently asked questions, which are updated from time to time to reflect developments, in order to provide information about the work of the ARRC, its progress to date and the overall effort to promote voluntary market adoption of its recommended alternative to US$ LIBOR, SOFR. The latest updated set was published by the ARRC on 31 January. The ARRC also posted an updated timeline of key milestones.

The National Working Group on Swiss Franc Reference Rates (NWG) met, on 5 February, to discuss current challenges in respect of the LIBOR transition in Switzerland and relevant international developments. At its previous meeting, in October 2018, the NWG recommended using a compounded SARON as a term rate alternative to the CHF LIBOR, wherever possible. The key item in this latest meeting was a discussion of the options for using a compounded SARON in cash products. The NWG members agreed on the following main recommendations: (i) market participants should consider and assess the options presented for using a compounded SARON; (ii) financial institutions should individually define action plans with respect to their product strategy; and (iii) exchanges are encouraged to facilitate the listing of SARON FRNs.

On 12 February, EMMI published a summary of stakeholder feedback on the *Second Consultation Paper on a Hybrid Methodology for EURIBOR*. This consultation is part of EMMI's commitment to deliver a reformed and robust methodology for EURIBOR, which aims to meet regulatory and stakeholder expectations in a timely manner. Feedback that was received shows broad support for EMMI's proposals. EMMI will file for authorisation to the Belgian FSMA by Q2 2019. Subsequently, EMMI will start transitioning panel banks from the current EURIBOR methodology to the hybrid methodology, with a view to finishing the process before the end of 2019.

IBA launched a survey on the use of LIBOR on 4 December 2018. The survey was open to all users of LIBOR and was designed to identify

**The Alternative Reference Rates Committee (ARRC) is publishing frequently asked questions.**

> **The BIS published its latest quarterly review, which includes a special feature *Beyond LIBOR*.**

the LIBOR settings that are most widely used. The survey closed on 15 February and the results have been published on IBA's website.

On 22 February, the summaries of responses on the feedback received on the €RFR WG's report on the transition from EONIA to ESTER and to the second public consultation on determining an ESTER-based term structure were published on the ECB website.

On 25 February, the European Commission issued a press release welcoming agreement on a new generation of low-carbon benchmarks. Importantly, this announcement includes confirmation that, "separately, the EU institutions also agreed to grant providers of "critical benchmarks" – interest rates such as EURIBOR or EONIA – two extra years until 31 December 2021 to comply with the new Benchmark Regulation requirements. Given the crucial importance of third-country benchmarks for EU companies, the extra two years for benchmarks produced outside the EU was also introduced to provide additional time for work with non-EU regulators on how these benchmarks can be recognised as equivalent or otherwise endorsed for use in the EU."

Further technical talks follow from this political agreement, for the finalisation of the text, and COREPER and the European Parliament will have to formally adopt the new rules before they can enter into force.

This agreement is also affirmed in a parallel announcement from the European Council, which states that, "finally, the text reviews existing provisions of the benchmarks regulation by providing an extension of the transition regime for critical and third-country benchmarks until the end of 2021."

On 5 March, the BIS published its latest quarterly review, which includes a special feature *Beyond LIBOR: A Primer on the New Benchmark Rates*. In this, the authors provide an overview of RFRs that will form the backbone of the new benchmark regime and compare some of their key properties with IBORs. Finding a one-size-fits-all benchmark for every currency may be neither feasible nor desirable, so that several types of reference rate may ultimately coexist.

A letter to ISDA, dated 12 March, from the Co-Chairs of the FSB's Official Sector Steering Group (OSSG) of regulators and central banks addressed the topic of derivative contract robustness to risks of interest rate benchmark discontinuation. The OSSG thank ISDA for its engagement and work so far in consulting on options for adopting more robust fallback language for derivatives referencing key IBORs.

The Co-Chairs welcome the very thoughtful and comprehensive responses that ISDA has received from market participants in its consultation for sterling LIBOR, Swiss franc LIBOR, Japanese yen LIBOR and TIBOR, and the Australian dollar BBSW. As ISDA now moves towards it final decisions for these currencies with this feedback in hand, three issues are raised which the OSSG views as particularly important and that they believe ISDA is moving to address: (i) the addition of other trigger events; (ii) the timing for an ISDA consultation on US dollar LIBOR and certain other IBORs; and (iii) the governance and transparency necessary as ISDA makes its final decisions.

On 12 March, the ECB announced that ESTER will henceforth be known as €STR. Following on from this, on 14 March, the ECB issued a press release confirming that it will start publishing €STR as of 2 October 2019, reflecting the trading activity of 1 October 2019. Additionally, the ECB is ready to further support private sector efforts in the transition away from EONIA and will provide the computation of a one-off spread between €STR and EONIA, as requested by the €RFR WG and calculated by the ECB according to the methodology publicly recommended by the €RFR WG. The resulting spread will be communicated on the day on which the change in the methodology of EONIA is announced and will be based on the pre-€STR and EONIA data as publicly available.

Also on 14 March, the ECB reported that the €RFR WG has endorsed recommendations to market participants regarding (i) the transition from EONIA to €STR; and (ii) the calculation of a €STR-based term structure. Among other things, the €RFR WG recommends that market participants gradually replace EONIA with €STR for all products and contracts, making €STR their standard reference rate and making certain adjustments to their IT systems. The €RFR WG recommended that EONIA's administrator, EMMI, modify the current EONIA methodology to become €STR plus a spread, for a limited period of time in order to give market participants sufficient time to transition to €STR. EMMI is also requested to engage with the relevant authorities to ensure that EONIA, under its evolved methodology, complies with the EU BMR. The €RFR WG also recommended a methodology for calculating that spread.

Finally, the €RFR WG recommended a methodology for calculating a forward-looking term structure based on €STR derivatives markets that could be used as a fallback in EURIBOR-linked contracts. The €RFR WG will now analyse further both the backward- and forward-looking approaches as potential fallbacks for EURIBOR, acknowledging work being done in other currency areas as well as by ISDA, which has announced the launch of a consultation on determining a fallback for EURIBOR-linked derivatives contracts following the start of the publication of €STR.

On 20 March, EMMI announced a public consultation on the change in the methodology of EONIA, as recommended by the €RFR WG. By conducting this consultation, EMMI intends to raise awareness of the implications of the suggested changes and ensure a timely preparation for the upcoming changes by EONIA's users.

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 30 now duly registered, and third country benchmarks, with 65,749 benchmarks (of which 10 relate to a Swiss administrator, with the BaFin as the relevant EU authority, and the remainder all relate to a single US administrator, with the AFM as the relevant EU authority) now duly 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 the BMR. The most recent update was published on 30 January.

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## Credit rating agencies

On 1 February 2019, it was announced that ESMA and European securities regulators have agreed MoUs with the UK FCA, as part of authorities' preparations should the UK leave the EU without a withdrawal agreement (the no-deal Brexit scenario) – the MoUs will therefore only take effect in the event of a no-deal Brexit scenario. The MoUs, which are similar to those already concluded on the exchange of information with many third country supervisory authorities, include an MoU between ESMA and the FCA covering the exchange of information in relation to the supervision of CRAs. Subsequently, on 15 March, the FCA published a statement on endorsement of credit ratings from the EU into the UK for regulatory use in the event of a no-deal Brexit. Alongside this, ESMA published its own statement, which clarifies endorsement of UK credit ratings in case of a no-deal Brexit.

On 5 February, ESMA published its revised Guidelines, following a public consultation in July 2018, on the information which CRAs need to report to it for supervisory purposes. These Guidelines amend some sections of ESMA's 2015 Guidelines on the reporting of periodic information to ensure they continue to support ESMA's supervisory processes in an efficient and effective manner. The main features of the revised Guidelines are: (i) differentiated reporting calendars for entities depending on required level of supervisory engagement; (ii) individual reporting instructions for each reporting item which have been elaborated and expanded in areas where ESMA has identified a supervisory need; and (iii) standardising reporting templates for specific reporting items.

On 19 February, ESMA published its 2019 *Direct Supervision Work Programme*, which among other things details the main areas of focus for the upcoming year for its supervision of CRAs. ESMA currently directly supervises 27 CRAs and carries responsibility for four certified CRAs. ESMA uses a risk-based approach to establish its annual Supervision Work Programme for CRAs and for 2019, the supervisory priorities will include CRA portfolio risk and quality of the rating process; and CRA Cybersecurity. In addition, other areas where ESMA will perform further work on CRAs include fees charged, the effectiveness of internal control systems, and the use of new technologies.

On 13 March, the Joint Board of Appeal (BoA) of the ESAs issued decisions regarding four appeals it received against decisions by ESMA regarding infringements of the EU CRA Regulation. While the BoA confirmed the infringements found by ESMA, it accepted the appellants' claims of having acted non-negligently and remitted the case to ESMA's Board of Supervisors to adopt amended decisions based on the BoA findings. In the context of the proceedings, the BoA also dismissed an application by one appellant to suspend ESMA's decision addressed to it. ESMA is currently studying the BoA's decisions, before deciding on the next steps.

On 18 March, ESMA announced that it had registered Beyond Ratings SAS as a CRA under the EU CRA Regulation, with immediate effect. Beyond Ratings SAS is based in Paris, France, and intends to issue sovereign and public finance ratings. With this latest addition, the total number of CRAs registered in the EU is 28 CRAs – amongst which four operate under a group structure, totaling 19 legal entities in the EU, which means that the total number of CRA entities registered in the EU is 43.

The most recent update to ESMA's Q&A on the application of the EU CRA Regulation was published on 18 December 2018.

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## OTC (derivatives) regulatory developments

On 1 February 2019, ESMA issued a public statement on how derivatives data reported under EMIR should be handled in the event of a no-deal Brexit scenario. EMIR mandates the reporting of all derivatives to ESMA supervised TRs, who centrally collect and maintain the records of all derivative contracts. EMIR requires both counterparties to a derivative contract to report its details to TRs. However, UK counterparties would not be mandated to report under EMIR to EU27 TRs following a no-deal Brexit. Therefore, the statement clarifies the following aspects for different reporting scenarios, namely where both counterparties are from the EU27, both are from the UK, and where one is from EU27 and the other from the UK. The statement clarifies: reporting by CCPs and counterparties; reconciliation and recordkeeping by TRs; access by EU27 authorities; and portability and aggregation by TRs.

The statement also sets out the timeline for completion of the relevant adjustments by the EU27 TRs. The FCA also published information on requirements for UK TRs and reporting counterparties, in a no-deal Brexit scenario; and a statement on FCA FIRDS and transaction reporting.

Then, on 4 February, it was announced that ESMA has agreed MoUs with the BoE for the recognition of CCPs and of the CSD established in the UK that would take effect should the UK leave the EU without a withdrawal agreement, the no-deal Brexit scenario. ESMA has previously communicated that its Board of Supervisors supports continued access to UK CCPs and to the UK CSD, in order to limit the risk of disruption in CCP clearing and to avoid any negative impact on EU financial stability. To limit the risk of disruption to the Irish securities market, it will also allow the UK CSD to continue to serve Irish securities. ESMA aims to recognise UK CCPs and the UK CSD in a timely manner, where the four recognition conditions under Articles 25 of EMIR and CSDR are met, respectively.

The conclusion of MoUs between ESMA and the BoE satisfies the third recognition condition – establishment of cooperation arrangements – under both regulations. The MoUs are a statement of intent to consult, cooperate and exchange information in connection with ESMA's immediate access, on an on-going basis, to all information it requests regarding the CCPs and CSD. ESMA aims to complete the next steps for the recognition of the UK CCPs and the UK CSD and to adopt the recognition decisions well ahead of Brexit date – the recognition decisions would take effect on the date following Brexit date, under a no-deal Brexit scenario.

Also, under the section on legislative initiatives and other legal acts, the Commission's Brexit preparedness website page includes details, posted on 30 January, about exemption of the BoE and the UK DMO with regards to OTC derivatives transactions; under MAR and under SFTR; and exemption of the BoE from MiFIR pre- and post-trade transparency requirements.

Subsequently, on 18 February, ESMA announced that, in the event of a no-deal Brexit, three CCPs established in the UK – LCH Limited, ICE Clear Europe Limited and LME Clear Limited – will be recognised to provide their services in the EU. ESMA has adopted these recognition decisions in order to limit the risk of disruption in CCP clearing and to avoid any negative impact on the financial stability of the EU. Having assessed the applications and the information submitted by the three CCPs, and consulted the relevant authorities in accordance with EMIR, ESMA considers that the conditions for recognition under Article 25 of EMIR are met by the three CCPs in case of a no-deal Brexit. The recognition decisions would take effect on the date following Brexit date, under a no-deal Brexit scenario.

Furthermore, on 11 March, the FCA published a statement on the reporting of derivatives under the UK EMIR regime in a no-deal scenario. This statement explains what TRs, and UK counterparties that use them, should do to make sure they are compliant with their EMIR reporting obligations after the UK leaves the EU.

Meanwhile, on 31 January, ESMA published a statement addressing EMIR Refit implementation. This public statement addresses issues around the clearing and trading obligations for small financial counterparties and the backloading requirement for reporting entities, ahead of upcoming deadlines, which would represent challenges for the above mention entities in the context of the ongoing EMIR Refit negotiations.

On 5 February, the European Commission welcomed the political agreement reached by the European Parliament and EU Member States on the targeted reform of EMIR, which will bring more proportionate rules for corporates. It exempts the smallest financial counterparties from the clearing obligation, while ensuring that the overwhelming majority of trades in the relevant classes of derivatives continues to be cleared in CCPs. The reporting requirements which ensure that supervisors dispose of full information on derivatives markets are streamlined and will be more proportionate while the quality of the reported data is ensured. This political agreement will be followed by further technical work before the European Parliament and Council can formally adopt the final texts.

On 20 February, the European Commission and the Monetary Authority of Singapore (MAS) announced a common approach for EU and Singapore derivatives trading venues to support the G20 reforms for standardised derivatives to be traded on trading platforms. The aim of the common approach is to facilitate EU financial counterparties' ability to comply with the EU derivatives trading obligation under MiFIR by executing swaps transactions on organised markets authorised in Singapore. Likewise, Singapore counterparties can engage with EU counterparts on the EU's MTFs or OTFs in compliance with Singapore's derivatives trading obligation. The trading obligation would cover interest rate swaps denominated in several currencies such as the US dollar, euro and sterling.

On 5 March, the BCBS and IOSCO issued a joint statement on the final implementation phases of the margin requirements for non-CCP cleared derivatives, providing guidance to support timely and smooth implementation of the framework and clarify its requirements. This affirms that amendments to legacy derivative contracts pursued solely for the purpose of addressing interest rate benchmark reforms do not require the application of the margin requirements for the purposes of the BCBS/IOSCO framework, although the position may be different under relevant implementing laws. It is also noted that the framework does not specify documentation, custodial or operational requirements if the bilateral IM amount does not exceed the framework's €50 million IM threshold, but that it is expected that covered entities will act diligently when their exposures approach the threshold to ensure that the relevant arrangements needed are in place if the threshold is exceeded.

On 13 March, the European Commission welcomed the political agreement reached by the European Parliament and EU Member States to ensure a more robust and effective supervision of CCPs offering services to the EU. The reform of EMIR introduces a more pan-European approach to the supervision of EU CCPs. It establishes, in particular, a Supervisory Committee within ESMA with independent members, national supervisors and central banks. For the supervision of third-country CCPs operating in the EU, based on the system of equivalence, it introduces a proportionate approach, recognising that some CCPs established outside the EU may be of such systemic importance that they require additional conditions to mitigate the potential risks – if additional supervisory tools are insufficient, the Commission can, upon request by ESMA, decide that a CCP will only be able to provide some or all of its services in the EU if it established in the EU. Further technical work will follow this political agreement so that the European Parliament and Council can formally adopt the final texts.

> **The European Commission welcomes the political agreement reached to ensure a more robust and effective supervision of CCPs offering services to the EU.**

Alongside this political agreement, the European Commission and the CFTC issued a joint statement on cross-border derivatives regulation. This reports that they expect the implementation of EMIR 2.2 and the CFTC's ongoing review of both its swaps regulatory framework and its cross-border approach will result in more deference between the CFTC and the EU supervisors than is currently the case.

On 20 March, it was announced that the Governing Council of the ECB has withdrawn its recommendation to amend Article 22 of the Protocol on the Statute of the ESCB and of the ECB regarding the extension of its legal competence over clearing and payment systems to CCPs. The draft amendment to the text of Article 22 that resulted from the discussions between the European Parliament, the Council and the Commission does not meet the objectives that informed the ECB's proposal, in the Governing Council's unanimous view. The ECB does not expect the withdrawal of its recommendation to prevent the adoption of the amended EMIR, the purpose of which is to enhance the regulatory framework for CCPs, in particular non-EU CCPs. The ECB welcomes the objective of the Regulation to improve the process of recognising and supervising third-country CCPs and to make it more rigorous for those CCPs that are of key systemic importance for the EU. Within its mandate, the ECB stands ready to contribute to its implementation.

On 28 March, ESMA published a statement on the implementation of the new EMIR Refit regime for the clearing obligation for financial and non-financial counterparties. This statement provides guidance on when financial and non-financial counterparties subject to EMIR need to determine whether they are subject to the clearing obligation under the new regime introduced by Refit, and equally when they need to notify ESMA and their relevant competent authority that they are indeed subject to the clearing obligation, ie on the day the Refit text enters into force.

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 4 February.

ESMA's list of CCPs authorised to offer services and activities in the EU, in accordance with EMIR, was last updated on 29 January; its list of third-country CCPs recognised to offer services and activities in the EU was last updated on 7 January; and its (non-exhaustive) list of CCPs established in non-EEA countries which have applied for recognition was last updated on 24 January. ESMA's *Public Register for the Clearing Obligation* under EMIR has not been updated since 6 December but, on 4 April, ESMA did update the public register of those derivative contracts that are subject to the trading obligation under MiFIR.

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## Market infrastructure

### *ECB: Advisory Groups on market infrastructure*

As reported in more detail in the previous edition of the Quarterly Report, the ECB's two advisory groups on market infrastructure, AMI-SeCo and AMI-Pay, both had their latest meetings on 20 November 2018. The programme of the day was split into two sessions, a joint meeting of both groups as well as an individual meeting of each of the two groups. More detailed summaries of all three meetings as well as the related presentations have been published on the ECB website. Following the meeting, members decided to establish an even closer collaboration between the two groups given the long list of common topics. The next meetings of AMI-SeCo and AMI-Pay, currently scheduled for 13 May, will therefore again include a joint discussion in addition to the meetings of the two groups.

Besides close collaboration with the existing advisory groups, the ECB is also trying to ensure a diverse representation and stakeholder input directly at the level of the ECB's Market Infrastructure Board (MIB). It is therefore looking for two new non-central bank members for the MIB with experience in the payments and securities industry. The official call for applications was published on 22 February 2019 in the *Official Journal*.

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

One area of particular focus for AMI-SeCo remains the extensive harmonisation work that is being undertaken in relation to collateral management. A key objective of this work is to prepare the ground for the launch of a Eurosystem Collateral Management System (ECMS) in November 2022, which once live will consolidate the currently fragmented process of managing eligible assets used as collateral for Eurosystem credit operations. The related harmonisation 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 workstreams.

The harmonisation work has made important progress. In particular, detailed harmonisation standards have been finalised covering the three areas most central to the ECMS project: (i) tri-party collateral management, (ii) corporate actions and (iii) CSD billing. These have been submitted for review to different stakeholder groups, including AMI-SeCo members and their constituencies, as well as the different National Stakeholder Groups (NSGs) who will also play a key role in the implementation of the standards. In the context of this latest consultation, ICMA submitted a short set of comments from a primary market perspective to raise awareness of the potentially wider impacts of the corporate action proposals on other business areas, including the new issuance process.

Work in other priority areas identified by the CMH-TF, including bilateral collateral management and margining practices, has been much more limited so far, but might pick up now that the key proposals have been finalised.

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

Besides the work undertaken by the CMH-TF, a number of other important ECB initiatives in the area of market infrastructure are currently under way. 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. Since the TIPS go live in November 2018, with initially eight banks connected, six further banks have joined the initiative taking their total number to 14.

**All the different ECB managed platforms, including T2, T2S, TIPS, ECMS, will be linked through a single access point for users.**

Another related initiative is the ongoing integration of TARGET2 (T2) payment services with the T2S platform for securities settlement. The project was launched in September 2016 with the consolidated platform scheduled to go live in November 2021. On 24 January, the ECB published a first version of the user detailed functional specifications (UDFS v.1.1) for the TARGET consolidation project. Stakeholders are invited to submit comments on the proposals by 5 April 2019.

All the different ECB managed platforms, including T2, T2S, TIPS, ECMS, will be linked through a single access point for users, the Single Market Infrastructure Gateway (ESMIG). On 31 January, the Eurosystem launched the related procurement procedure to select the relevant network service providers who will develop and offer the related connectivity services. Users will be able to choose from different service providers who will be selected by mid-July 2019.

The ECB is organising a two-day conference to discuss how to build An innovative single market for the euro. The conference will take place on 6-7 May at the ECB's main building in Frankfurt. The programme will cover a broad range of issues, including the role of market infrastructure in driving innovation, approaches to creating a true domestic market for Europe and innovations in the payments space and card payments.

### *ECB: Market contact groups*

Members of the Bond Market Contact Group (BMCG) last met on 12 February. Three main topics were on the agenda for this meeting. As usual, members started by discussing the broader bond market outlook, this time introduced by EFAMA. BMCG members also reviewed recent developments in the euro area sovereign bond primary market, including changes to the issuance patterns of DMOs over the past years and the status of the Primary Dealership model in Europe. This agenda item was based on presentations provided by the ECB and BNP Paribas. Finally, members also assessed the impacts on liquidity in the euro area bond markets following the end of net purchases under the ECB's Asset Purchase Programme (APP). This discussion was introduced by representatives of DWS and Tradeweb. A more detailed summary of the meeting is available on the ECB website. The next quarterly meeting of the BMCG will be held on 12 June 2019.

The latest meeting of the Money Market Contact Group (MMCG) was held on 12 March. No documents from this meeting have been made available yet. However, a summary of the previous meeting of the MMCG on 3 December is now available on the MMCG webpage. Alongside the summary itself a number of relevant presentations have been published including on Brexit, 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. The next regular MMCG meeting is scheduled for 25 June.

### *European Commission*

On 22 March, the final technical standards specifying the extensive reporting requirements for securities financing transactions (SFTs) introduced by the EU SFT Regulation (SFTR) were published in the *Official Journal.* These will enter into force on 11 April 2019 and formally apply after a 12-month transition period, ie on 11 April 2020 for banks and investment firms. The scope will then be gradually extended to other types of reporting firms over the following months (for further details see Repo and Collateral section above).

### *ESMA: Post-trading*

ESMA is playing an important role in the SFTR implementation process. Beyond the SFTR technical standards, ESMA is currently preparing the release of a number of further so-called Level 3 measures, including Q&As, validation rules, but also more detailed Reporting Guidelines, a first draft of which is expected to be published in April or May for public consultation.

In the context of CSDR implementation, the role of ESMA is equally important. Among other things ESMA maintains a central register to track the registration of CSDs under the new harmonised framework. Since the latest update in the previous Quarterly Report, two further CSDs have been added to the list, bringing the total number of EU CSDs already authorised to ten. The latest additions to the list are the Czech CSD, CSD Prague, as well as CDCP SR from Slovakia.

As part of its preparations for a possible no-deal Brexit, ESMA announced on 1 March that it will recognise the UK CSD, Euroclear UK and Ireland as a third country

**ESMA issued a useful overview of all the measures taken to date in order to prepare for the no-deal Brexit scenario.**

CSD under CSDR. This follows up on a similar announcement made on 18 February in relation to three UK CCPs, LCH Limited, ICE Clear Europe Limited and LME Clear Limited, which would be recognised as third country CCPs under EMIR in the case of a no-deal Brexit. Under CSDR, EUI would be the first third country CSD to be recognised, while the list of recognised third country CCPs under EMIR already covers 32 firms. On 28 March, ESMA issued a useful overview of all the measures taken to date in order to prepare for the no-deal Brexit scenario.

In the context of EMIR, ESMA is also responsible for the supervision and authorisation of trade repositories (TRs). Two new TRs have been authorised since the last update. One of them is UnaVista TRADEcho B.V., established in the Netherlands, which was authorised on 25 March. The other newly authorised TR is DTCC's Data Repository (Ireland) Plc, added on 1 March. On the same day, ESMA also withdrew the authorisation of Bloomberg TR Ltd upon request, bringing the total number of authorised TRs under EMIR back to nine.

### *BIS: Committee on Payments and Market Infrastructures (CPMI)*

CPMI jointly with IOSCO continue to monitor the implementation of the 2012 Principles of Financial Market Infrastructures (PFMI), a set of international standards for payment systems, CSDs and securities settlement systems, CCPs and trade repositories. The monitoring is done at three different levels. The Level 1 assessment reports are based on self-assessments by individual jurisdictions on how they have implemented the different PFMIs. In July 2018, along with a detailed Fifth update to the Level 1 assessment reports, CPMI-IOSCO launched an online tracker system to allow jurisdictions to more easily update their ratings and make the information more readily available. The latest more comprehensive update to the useful online tracker was done on 14 March.

In parallel, CPMI and IOSCO continue to monitor jurisdictions' progress at Levels 2 and 3. The latest report in the series of Level 2 reports analysing the completeness of individual jurisdictions' implementation measures and their consistency with the PFMI was published on 30 January, focussing on Switzerland. This complements similar reports already published for the EU, Japan, the US, Australia, Hong Kong, Singapore and Canada. The full list of PFMI monitoring reports covering all three levels is available on the CPMI-IOSCO website.

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# FinTech in International Capital Markets

*by Gabriel Callsen*

## Fintech regulatory developments

### *ESMA: analysis of RegTech and SupTech – change for markets and regulators*

On 14 March 2019, ESMA stated it had carried out an analysis of the regulatory and supervisory technologies currently being developed in response to various demand and supply drivers. The results of this analysis are presented in an article in the latest *Trends, Risks, and Vulnerabilities (TRV) Report (No 1.2019)*. ESMA finds that, on the demand side, regulatory pressure and budget limitations are pushing the market towards an increased use of automated software to replace human decision-making activities. This trend is reinforced by supply drivers such as increasing computing capacity and improved data architecture. Market participants are increasingly using new automated tools in areas such as fraud detection, regulatory reporting and risk management, while potential applications of new tools for regulators include greater surveillance capacity and improved data collection and management.

### *BCBS: statement on crypto-assets*

On 13 March 2019, the BCBS released a statement on crypto-assets. While the crypto-asset market remains small relative to that of the global financial system, and banks currently have very limited direct exposures, the Committee is of the view that the continued growth of crypto-asset trading platforms and new financial products related to crypto-assets has the potential to raise financial stability concerns and increase risks faced by banks. […] The BCBS is setting out its prudential expectations related to banks' exposures to crypto-assets and related services in relation to due diligence, governance and risk management, disclosure requirements and supervisory dialogue, for those jurisdictions that do not prohibit such exposures and services. […] The BCBS will in due course clarify the prudential treatment of such exposures to appropriately reflect the high degree of risk of crypto-assets. It is coordinating its work with other global standard setting bodies and the FSB.

### ESMA: Trends, Risks, and Vulnerabilities (TRV) Report (No 1.2019)

On 28 February 2019, ESMA published its latest *Trends, Risks, and Vulnerabilities (TRV) Report (No 1.2019)*. In the section on Products and innovation (pages 25-30), ESMA notes with regard to initial coin offerings (ICOs) that "around EUR 17bn have been raised through ICOs in 2018 globally, compared with EUR 5.4 billion in 2017, ie a more than threefold increase year on year. However, almost 90% of the volumes raised in 2018 have been collected in the first half of the year and monthly issuance volumes are now closer to 2017 levels." Furthermore, ESMA observes that "some FinTech firms have started establishing inroads in credit provision and payments. FinTech credit is growing rapidly but is still small when considered as a proportion of overall credit in most jurisdictions. [...] The competitive impact of technology firms that begin to offer financial services (TechFins) (eg Alibaba, Baidu, Amazon) is likely greater than that of FinTech firms."

### FSB: FinTech developments and potential financial stability implications

On 14 February 2019, the FSB published a report on FinTech and market structure in financial services. The publication is part of the FSB's ongoing work to monitor FinTech market developments and their potential implications for financial stability. [...] Some key considerations from the FSB's analysis of the link between technological innovation and market structure are the following:

- To date, the relationship between incumbent financial institutions and FinTech firms appears to be largely complementary and cooperative in nature.
- The competitive impact of BigTech may be greater than that of FinTech firms. BigTech firms typically have large, established customer networks and enjoy name recognition and trust.
- Reliance by financial institutions on third-party data service providers (eg data provision, cloud storage and analytics, and physical connectivity) for core operations is estimated to be low at present. However, this warrants ongoing attention from authorities.

### GFIN: cross-border testing pilot for innovative firms open to applications

On 31 January 2019, the Global Financial Innovation Network (GFIN) – a group of 29 international organisations including the FCA – invited applications from firms wishing to test innovative financial products, services or business models across more than one country or jurisdiction. Currently chaired by the FCA, the GFIN is an international network of organisations committed to supporting financial innovation in the interests of consumers. The network was developed following the FCA's earlier proposal to create a global sandbox. The FCA's sandbox, which allows firms to test innovative ideas in a live market environment, was a first for financial services regulators across the world. [...] Firms interested in applying to take part in the pilot in the UK should review the list of participating regulators and submit an application before the deadline – 28 February 2019. The terms of reference of the GFIN are available on the FCA's website.

### ESMA: advice on crypto-assets need common EU-wide approach to ensure investor protection

On 9 January 2019, ESMA published its Advice to the European Union (EU) Institutions – Commission, Council and Parliament – on initial coin offerings and crypto-assets. The Advice clarifies the existing EU rules applicable to crypto-assets that qualify as financial instruments, and provides ESMA's position on any gaps and issues in the current EU financial regulatory framework for consideration by EU policymakers. These gaps and issues fall into two categories:

- For crypto-assets that qualify as financial instruments under MiFID, there are areas that require potential interpretation or re-consideration of specific requirements to allow for an effective application of existing regulations.

**The competitive impact of BigTech may be greater than that of FinTech firms. BigTech firms typically have large, established customer networks and enjoy name recognition and trust.**

- Where these assets do not qualify as financial instruments, the absence of applicable financial rules leaves investors exposed to substantial risks. At a minimum, ESMA believes that Anti Money Laundering (AML) requirements should apply to all crypto-assets and activities involving crypto-assets. There should also be appropriate risk disclosure in place, so that consumers can be made aware of the potential risks prior to committing funds to crypto-assets.

### *EBA: report on crypto-assets*

On 9 January 2019, the EBA published the results of its assessment of the applicability and suitability of EU law to crypto-assets. Typically, crypto-asset activities do not constitute regulated services within the scope of EU banking, payments and electronic money law, and risks exist for consumers that are not addressed at the EU level. Crypto-asset activities may also give rise to other risks, including money laundering. In light of these issues, the EBA recommends that the European Commission carry out further analysis to determine the appropriate EU-level response. The EBA also identifies a number of actions that it will take in 2019 to enhance the monitoring of financial institutions' crypto-asset activities and consumer-facing disclosure practices.

### *BIS: proceeding with caution – a survey on central bank digital currency*

On 8 January 2019, the BIS published the report *Proceeding with Caution – a Survey on Central Bank Digital Currency*. Across the world, central banks are reportedly thinking about how new central bank digital currencies (CBDCs) could replace traditional money (CPMIMC (2018)). There is significant public interest in such a fundamental potential change, and this paper takes stock of central banks' current work and thinking. It is based on a recent survey of central banks to which 63 responded (representing jurisdictions covering close to 80% of the world population). The survey asked central banks about their current work on CBDCs, what motivates that work, and how likely their issuance of a CBDC is. The survey shows that, although a majority of central banks are researching CBDCs, this work is primarily conceptual and only a few intend to issue a CBDC in the short to medium term.

### *ESAs: joint report on regulatory sandboxes and innovation hubs*

On 7 January 2019, the ESAs published a joint report on innovation facilitators (regulatory sandboxes and innovation hubs). The report sets out a comparative analysis of the innovation facilitators established to date within the EU. The ESAs also set out best practices for the design and operation of innovation facilitators. The number of innovation facilitators in the EU has grown rapidly in recent years. As at the date of the report, 21 EU Member States and three EEA States have established innovation hubs and five EU Member States have regulatory sandboxes in operation. A comparative analysis of these national innovation facilitators is set out in the report and, based on this analysis, a set of best practices has been prepared. The best practices are intended to: (i) promote consistency across the single market in the design and operation of innovation facilitators; (ii) promote transparency of regulatory and supervisory policy outcomes from arising from interactions in the context of innovation facilitators; and (iii) facilitate cooperation between national authorities, including consumer and data protection authorities.

**Contact: Gabriel Callsen**
gabriel.callsen@icmagroup.org

# Where is my blockchain bond?

*By Scott Farrell, King & Wood Mallesons*

The emergence and development of FinTech in the capital markets demonstrates how innovation happens at the edges, where knowledge disciplines which were once separate suddenly connect. A prime example is blockchain[1], a specific application of distributed ledger technology (DLT). Its potential for application to capital markets could drive an unprecedented level of knowledge sharing and collaborative thought leadership between technology, financial markets and legal experts. This article gives an example of the need for this collaboration by describing one fundamentally novel legal issue that emerges in the use of blockchain in the capital markets which cannot be solved by technology alone.

Blockchain, and distributed ledger technology, can be seen as a method of recording information. It provides auditability, resilience and trust through the record being *immutable* (new entries can be added to previous ones which cannot be changed or erased), *distributed* (the record is held in more than one place by more than one person) and *synchronised* (the record is validated by agreement between the distributed versions, which is established through consensus mechanisms). The detail is more complicated, and there are other potential enhancements like smart contracts and tokens, but this simplified explanation is a good starting point for considering blockchain's use in capital markets.

Capital markets practice requires many records of information, such as records of holdings of financial instruments, payment details and terms of contracts. Currently, this is often conducted by trusted parties using a centralised form of record-keeping. Blockchain provides an alternative to centralised record-keeping and establishes reliability in a different way - through its distributed nature rather than trust in a single safe entity. This distribution is fundamental to using blockchain to establish records which are auditable, resilient and can be trusted. And it is through this distribution that the novel legal issue arises.

Records of financial instruments in the capital markets are usually held through intermediaries such as custodians and clearing systems. The tracing of a person's entitlement to a financial instrument through these arrangements can be complex both practically and legally but it is facilitated by the existence of a hierarchy of intermediaries. For example, an issuer of a bond may undertake to pay the amounts due to the person recorded on the register of bondholders, the registrar may record that a clearing system is the holder of the bond on that register, that clearing system may record that it holds those bonds for a custodian and that custodian may record that it holds that interest in bonds for the ultimate beneficial bond holder. There is a cascading series of interests, where one entity's entitlement is constituted by it being recorded by the intermediary one higher in the chain.

1. See also "An introductory Q&A on blockchain technology" by Alexander Westphal, ICMA (published in the ICMA Quarterly Report, Fourth Quarter 2015)

Legally, this arrangement has been useful because it enables a solution for a very complex problem: *where* is someone's entitlement in the bonds located if the registrar, clearing system, custodian and bond holder are all in different countries with different laws? This is important to working out which laws apply to matters such as taking security, effectiveness of transfers and insolvency. These are areas of law which look at financial instruments as property, and not just as contracts between parties. The solution which has emerged, and is now widely used, is to treat someone's rights as being located in the place where the intermediary that actually records *their* interest is (called the Place of the Relevant InterMediary Approach or PRIMA). Over the years this approach has been supported by agreements between countries and the enactment of local laws and it has brought valuable clarity where previously there was confusion.

This is complicated by the use of blockchain. By its very nature, blockchain involves keeping distributed records which could be maintained in more than one country at the same time. Also, the validity of the record is established by the consensus between the different versions, so there is no hierarchy naturally established between them. One does not need to count more than any other. For example, if a bondholder's interest in bonds is being recorded by its custodian in a distributed ledger maintained by it and its related entities in multiple countries, where is that interest located and which law applies? In other words, how do you work out the place of the intermediary when there is more than one intermediary in more than one place?

Unlike many legal issues related to blockchain in capital markets, this is genuinely novel because it arises from the distinctive feature of blockchain and its fundamental difference with centralised record-keeping: the distribution of the ledger. It is not a theoretical issue, and it has very real consequences for those holding, granting and taking interests in valuable instruments using practices which are common in today's markets.

It is not a problem without a solution. Importantly, these solutions are not based in technology, as the issue emerges from the fundamental feature of the technology. Such solutions need to be founded in a broader context, in capital markets practice and law. For example, there are methods of constructing the legal architecture which supports a particular use of blockchain which can manage the issue effectively. The use of the blockchain's legal architecture will be important until the sort of cross-border consistency of local laws which supports PRIMA develops.

Finding solutions for new issues is often part of developing new technology and it should not dissuade using it to better solve problems and improve customer experience. Instead, it is hoped that this brief description shows how financial markets expertise and experience is needed to complement technological understanding and skill to achieve the efficient and effective use of this transformative technology in capital markets.

## DLT in capital markets

A listing of new FinTech applications in bond markets, most of which are based on distributed ledger technology, is available on ICMA's dedicated FinTech webpage. Over the last two years, there has been a growing number of announcements, proofs of concept and live transactions involving DLT across the lifecycle of securities. Over 20 examples, taken from public sources, illustrate how DLT could be applied for the issuance and trading of bonds, repo and collateral management as well as asset management.

# ICMA Capital Market Research

*ICMA ERCC Briefing Note: The European Repo Market at 2018 Year-end*
**Published:** 15 January 2019
**Author:** Andy Hill, ICMA

*ICMA AMIC/EFAMA Report on Liquidity Stress Tests in Investment Funds 2019*
**Published:** 8 January 2019
**Authors**: ICMA/EFAMA Joint Report

*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

# Register Now May 15 to 17, 2019

## ICMA Annual General Meeting and Conference

Stockholm

**Register now to join fixed income professionals from the international market at the 51st ICMA AGM and Conference in Stockholm. ICMA member firms have an allocation of free places and the conference is also open to all interested financial market participants and press.**

**Contact: membership@icmagroup.org**

## WEDNESDAY MAY 15, 2019

**18:30-23:30 Welcome Reception at Artipelag**

## THURSDAY MAY 16, 2019

**08:00 Registration and Exhibition open**

**09:00 Annual General Meeting**
Stockholm Waterfront Congress Centre
*Open to ICMA members only*

Featuring a panel discussion with the Chairs of ICMA's market practice and regulatory policy committees:

**Moderator:** Paul Richards, Head of Market Practice and Regulatory Policy, ICMA

Panellists:
**Martin Egan,** BNP Paribas, Chair of ICMA Primary Market Practices Committee
**David Hopkins,** NatWest Markets, Chair of ICMA Legal & Documentation Committee
**Sonali Das Theisen,** Bank of America Merrill Lynch, Co-chair of ICMA Secondary Market Practices Committee
**Godfried De Vidts,** Former Chair of ICMA European Repo and Collateral Council and Committee
**Stéphane Janin,** AXA Investment Managers, Vice-Chair of ICMA Asset Management and Investors Council and Executive Committee
**Ed Wells,** HSBC bank plc, Chair of ICMA Regulatory Policy Committee

**11:30 Lunch**

**12:30 Open of Conference**
**Welcome Remarks Mandy DeFilippo,** Chair, ICMA

**12:45 Keynote address: Payment market in transition and challenges to the Riksbank operational framework Stefan Ingves,** Governor and Chairman of the Executive Board, Sveriges Riksbank

**13:00 Panel: The global markets in today's geopolitical and regulatory landscape: a forum of industry leaders**

Moderator: **Mandy DeFilippo,** Managing Director, Global Head of Risk Management for Fixed Income & Commodities, Morgan Stanley and Chair, ICMA

Panellists:
**Jakob Groot,** Member of the Executive Board, C&I, Danske Bank
**Isabelle Mateos y Lago,** Managing Director and Global Chief Multi-Asset Strategist, BlackRock
**Henrik Normann,** President, Nordic Investment Bank
**Per-Åke Nyberg,** Global Head of Investment Banking, Swedbank
**Paco Ybarra,** Deputy Head of Institutional Clients Group & Global Head of Markets and Securities Services, Citigroup

**14:00 Coffee break**

**14:20 Keynote address: Aerdt Houben,** Director, Financial Markets, De Nederlandsche Bank N.V.

**14:35 Panel: Sustainable debt markets – going mainstream**
Moderator: **Lars Eibeholm,** Head of Treasury and Sustainability Ratings, Nordic Investment Bank

Panellists:
**Alban de Faÿ,** Head of SRI Fixed Income Processes, Amundi
**Christopher Flensborg,** Head of Climate & Sustainable Finance, Skandinaviska Enskilda Banken AB
**Ulrika Lindén,** Head of Fixed Income, Swedbank Robur
**Chrissa Pagitsas,** Vice President, Enterprise ESG Strategy, Fannie Mae
**Ignacio Vicente,** Chief Financial Officer, Instituto de Crédito Oficial

**15:35 Coffee break**

**15:55 Keynote address: Verena Ross,** Executive Director, European Securities and Markets Authority

**16:10 Panel: 10 years after the crisis – is the international securities market in better shape?**
Moderator: **Katie Martin,** Capital Markets Editor, Financial Times

Panellists:
**Alexi Chan,** Global Co-head, Capital Markets, HSBC
**Frank Czichowski,** Senior Vice President & Treasurer, KfW
**Sebastien Domanico,** Global Head of Debt Capital Markets, Crédit Agricole Corporate and Investment Bank
**Christopher Rees,** Group CFO, Nordea Bank Abp
**Hans Stoter,** Global Head of Core Investments, AXA Investment Management

**17:10 Keynote address: Future of sustainable financing for Telia as a New Generation Telco**
**Christian Luiga,** EVP and Group CFO, Telia Company

**17.25 Keynote address: The great challenges in today's strategic environment Knud Bartels,** Retired General, Former Chief of Defence of Denmark and Former Chairman, NATO Military Committee

**17:40 Closing remarks**
**Martin Scheck,** Chief Executive, ICMA

**17:45 Close of Conference Day 1**

**19:00-19:45 Cocktail Reception**
**Exhibition area, Stockholm Waterfront Congress Centre**

**20:00-01:00 Gala Reception** Vasa Museum

## FRIDAY MAY 17, 2019

**08:30 Exhibition area open**

**09:15 Conference Day 2**
Stockholm Waterfront Congress Centre
*Open to all delegates*

**09:15 Opening remarks**
Martin Scheck, Chief Executive, ICMA

**09:20 Keynote address: Europe's Capital Markets Union: stocktaking and future prospects** John Berrigan, Deputy Director-General, Financial Stability, Financial Services and Capital Markets Union, European Commission

**09:35 Panel: Collateral damage? Opportunities and risks for the repo market in today's collateralised financial market system**

Moderator: **Godfried De Vidts,** Senior Advisor, ICMA

Panellists:
**John Berrigan,** Deputy Director-General, Financial Stability, Financial Services and Capital Markets Union, European Commission
**Richard Comotto,** Senior Consultant, ICMA
**Richard Hochreutiner,** Head of Global Collateral, Swiss Reinsurance Company Ltd
**Grigorios Markouizos,** Global Head of Fixed Income, Finance and Collateral Management, Citigroup
**Per Sjoberg,** Non-executive director, TriOptima and AcadiaSoft

**10:25 Panel: Transition to risk free rates: the challenges for market participants**
Moderator: **Paul Richards,** Head of Market Practice and Regulatory Policy, ICMA

Panellists:
**Roman Baumann,** Head of Money Market, Swiss National Bank
**Cornelia Holthausen,** Deputy Director General, Directorate General Market Operations, European Central Bank
**Harriet Hunnable,** Manager, Benchmarks Policy, Financial Conduct Authority
**Matthew Lieber**, Director of Capital Markets and Institutions, Markets Group, Federal Reserve Bank of New York

**11:15 Coffee break**

**11:45 Keynote address: Financial Markets Engineering with Blockchain** Professor Roman Beck, Head of European Blockchain Center, IT University of Copenhagen

**12:05 Panel: AI, Fintech and the future of fixed income issuance and trading**
Moderator: **Douglas Arner,** Kerry Holdings Professor in Law, University of Hong Kong

Panellists:
**Scott Farrell,** Partner, King & Wood Mallesons
**Duncan Phillips,** Managing Director, Global Head of Capital Markets, Ipreo
**Avtar Sehra,** CEO, Nivaura
**Andrei Serjantov,** Global Head of Electronic Primary and Credit Markets, BNP Paribas
**Santiago Braje,** Global Head of Credit Trading, ING

**12:55 Keynote address: The European Union in the New World Disorder Alexander Stubb,** Vice President, European Investment Bank and Former Prime Minister & Finance Minister of Finland

**13:10 Closing remarks**
**Martin Scheck,** Chief Executive, ICMA

**13:20 Close of Conference Day 2**

**13:20 Lunch**

**14:30 Close of Event**

The Green Bond Principles | The Social Bond Principles | The Sustainability Bond Guidelines

**Register Now**

**2019 Green Bond Principles and Social Bond Principles**

Annual General Meeting & Conference

13 June 2019 I Frankfurt

ICMA International Capital Market Association | Green and Sustainable Finance Cluster Germany

**Registration is open for the 2019 Green Bond Principles and Social Bond Principles Annual General Meeting and Conference, in Frankfurt on 13 June.**


All interested financial market participants are invited to attend The Covered Bond Investor Conference, hosted by the ICMA Covered Bond Investor Council and The Covered Bond Report this year in Frankfurt.

## How to survive and thrive in your capital market career, Amsterdam, 25 April

ICMA Future Leaders
Career Progression, Education, Networking.

ICMA members are invited to an evening of networking in Amsterdam with networking drinks at ABN AMRO's bar on the 23rd floor after a brief discussion between a panel of established capital market professionals about their own career experiences, giving their top tips for success in a competitive international business environment.

The evening, organized by the ICMA Future Leaders, will be of particular benefit to anyone in the earlier stages of their career, but all ICMA members in the region are encouraged to attend!

ICMA Future Leaders was set up to encourage the younger generation of finance professionals to be more involved with the association, providing them access to the range of services and networking opportunities that ICMA provides to its members and helping them to enhance their career progression in the debt capital markets.

**Contact: futureleaders@icmagroup.org**

**SAVE THE DATE:**

**First ICMA FinTech Forum, London, 25 June**

**SAVE THE DATE:**

ICMA Women's Network
Networking. Progression. Support.

**ICMA Women's Network Summer Event, London, 5 June**

## ICMA Workshops

| DATE | |
|---|---|
| 4 June *Register* | **ICMA Intensive One-Day Workshop: Repo & the European Repo Market, London, 4 June** Short but comprehensive and therefore intensive training for anyone needing a detailed familiarisation with repo and the repo market who do not have two or three days to spare. Suitable for staff from all departments of firms active in the repo market as well as for those firms who support repo market participants such as legal advice and technology. |
| 26-28 June *Register* | **Repo and securities lending under the GMRA and GMSLA, London 26-28 June.** Analysis of 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. |
| 2 July *Register* | **NEW WORKSHOP - SFTR Reporting in Practice, London, 2 July** Ahead of the 2020 implementation ICMA is offering a one day workshop on the practical aspects of reporting of repo transactions which will be required under the EU Securities Financing Transactions Regulation (SFTR). The workshop will describe how and when repos (repurchase transactions and buy/sell-backs) should be reported to SFT trade repositories (subject to further clarification of some elements by ESMA), and highlight the challenges and, where possible, suggest solutions developed by the ICMA SFTR Task Force. |

Courses 2018

ICMA Executive Education

## Primary Markets Certificate (PMC)

The global financial crisis of a decade ago prompted a fundamental overhaul of the financial markets, introducing stricter requirements for bank capital and leverage. The capital markets feared that these new draconian rules would seriously impede their development, particularly for new borrowers. However, the debt primary markets have continued to flourish. Why?

The negotiable debt markets provided a viable and resilient alternative to both bank lending and the syndicated loan markets, where the new balance sheet constraints hit most acutely. The bond market has adapted to the new environment, changing primary market and syndication practices to reduce underwriting risk and to reward banks for balance sheet usage.

In more recent times, the regulators' focus has been on product governance and conflict of interest issues arising in these active primary markets. New regulatory reporting requirements are continuously being introduced adding to the burden on syndication and compliance departments.

The ICMA Primary Market Certificate (PMC) will help you understand the current market practices in the industry, get familiar with the documentation involved in bond issuance and bring you up to date with the current regulation impacting the primary market, including the Prospectus Regulation, Market Abuse Regulation (MAR) and MiFID II – London, 20-24 May.

*Chris O'Malley (Consultant at ICMA and Director of the ICMA Primary Market Certificate – PMC) and Kate Craven (Senior Advisor at ICMA and Director of the ICMA Introduction to Primary Markets Qualification – IPMQ)*

## Book now for these ICMA Executive Education Courses

**Financial Markets Foundation Qualification (FMFQ)**
**London, 12-14 June 2019**

**Securities Lending & Borrowing - Operational Challenges**
**London, 17-18 June 2019**

**OTC Derivative Operations: Products, Collateral, EMIR**
**London, 17-18 June 2019**

**Collateral Management**
**London, 7-8 October 2019**

**Introduction to Primary Markets Qualification (IPMQ)**
**London, 9-11 October 2019**

**Introduction to Fixed Income Qualification (IFIQ)**
**London, 9-11 October 2019**

**ICMA Fixed Income Certificate (FIC)**
**Amsterdam, 21-25 October 2019**

**Financial Markets Foundation Qualification (FMFQ)**
**London, 6-8 November 2019**

**ICMA Primary Market Certificate (PMC)**
**London, 11-15 November 2019**

**Securities Operations Foundation Qualification (SOFQ)**
**Brussels, 13-15 November 2019**

**ICMA Operations Certificate Programme (OCP)**
**Brussels, 18-22 November 2019**

| | |
|---|---|
| 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 |
| GBS | Green Bond Standard |
| 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 Board | International Accounting Standards |
| 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 für 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 |
| TONAR | Tokyo Overnight Average rate |
| TRs | Trade repositories |
| UKLA | UK Listing Authority |
| VNAV | Variable net asset value |

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