Secondary Market Practices Committee

Meeting of the ICMA SMPC, June 4th, 2019

The meeting was held at Goldman Sachs, London, and Chaired by David Camara

Attendees

In the room:

David Camara	Goldman Sachs	(Co-chair)
Aalok Gupta	BAML	
Andrew Wallhead	Barclays	
Sander Schol	BGC Partners	
Andrei Serjantov	BNP Paribas	
Nick Robinson	Insight Investment	
Kate Finlayson	JP Morgan	
Santiago Braje	ING	
Mathieu Casadevall	Societe Generale	
Andy Hill	ICMA	(Secretary)
Liz Callaghan	ICMA	
Paul Richards	ICMA	

Guests:

Alan Farrell	Goldman Sachs

On the line:

Daniel Mayston	BlackRock
Brian Lynch	BNY Mellon
Stephane Malrait	ING
Barbara Zittucro	Intesa San Paulo
Julien Morris	Jefferies
Lida Sun	Jefferies
Paula Alves	Societe Generale
Sylvie Bonduelle	Societe Generale
Christoph Hock	Union Investment
Godfried de Vidts	ICMA
Martin Scheck	ICMA

Agenda items

1. Implications of LIBOR transition

Presentation by Alan Farrell, Treasury, Goldman Sachs – head of LIBOR Transition Team, EMEA

Background

In August 2018 Goldman Sachs established a global team to manage LIBOR discontinuation. The focus of the team is very much cross-cutting with a realization that LIBOR impacts a range of trading and investment activities and contractual liabilities. LIBOR is not only the reference rate for multiple traded products, but it is also imbedded in various contracts as well as utilized in the banks' internal models and systems.

The SMPC was informed that Goldman Sachs, along with many other UK banks, had provided feedback to the FCA and PRA's 'Dear CEO' letter of September 2018[1], and that the Regulators' observations on the feedback would be published the next day (June 5),[2] as well as being discussed at a BoE/FCA LIBOR event.

Goldman Sachs' approach had been firstly to identify where LIBOR touched or impacted its various businesses, what would be the likely implications of the changes, and then to produce recommendations on how best to manage it. What was surprising was the second and even third order impacts of LIBOR, such as money market fund prospectuses which describe the fund's risks parameters in terms of LIBOR.

GS SOFR issue

The SMPC was informed that in May 2019 Goldman Sachs issued its first floating rate note referencing SOFR (the US Secured Overnight Financing Rate). Whilst not the first SOFR-based bond issuance, the GS 2-year callable note is unique in that it applies a compounding methodology, similar to sterling SONIA-based issuance, (previous SOFR issues have used simple averaging), and that it employs a two-day look back (a five-day lookback methodology has tended to be the norm for issues referencing overnight index rates).

Demand for the issue had been robust. Originally it had been scheduled as a $500mm issue but was increased to $1bn. It was still x2.5 over-subscribed Normal benchmark issues tend to attract between 40 and 80 different investors, and this was no different, despite original concerns that there may not be sufficient depth of interest. Furthermore, it priced similar to LIBOR-based issues (adjusted) and had performed similarly to conventional issues in the secondary market post-issuance. While there had been the requirement for some investor education around compounding methodology, there did not appear to be any system challenges for investors.

[1] See: Dear CEO LIBOR letter, 9/19/2018
[2] See: Feedback on the Dear CEO letter on LIBOR transition, 6/05/19

Fall-back for bonds

It was explained to the Group that there had been a number of ISDA consultations that may be of relevance to the bond markets. In particular, one was on the calculations to be applied in moving from LIBOR to overnight index rates (not particularly controversial in itself), while another was on pre-cessation triggers. It was suggested that it may be worthwhile understanding the conditions under which LIBOR can cease to exist and how regulators may have control over how any fallback provisions may be applied.

This also suggests that a lot of work is still required to identify what existing fallback provisions apply for all outstanding bond issuance referencing LIBOR. It may be possible to work with infrastructure providers to collate this data, and then further to systemize the bucketing of different fallback types which could then be made available alongside other relevant static bond data (such as Bloomberg's DES page).

Discussion

It was noted that the recent Goldman Sachs SOFR issue had been quite innovative and that it would be interesting to see whether this helped to pave the way for market best practice, particularly with respect to standardizing issue terms for bonds referencing OI rates across different markets and jurisdictions.

2. ICMA's MiFID II Data Quality Task Force

Briefing

Liz Callaghan (ICMA) reminded the SMPC that in order to tackle the challenges of post-trade data quality in the EU, ICMA had created a task force on post- trade data quality. This task force convened data experts from trading venues and market data providers, sell-sides, and buy-sides. The task force identified challenges and proposed solutions, which comprises ESMA's two main databases: 'FIRDS' Financial Instruments Reference Data System[3] and 'FITRS' Financial Instruments Transparency System.[4]

In January 2019, ICMA's data quality task force created a table of the identified FIRDS and FITRS data challenges and proposed workable solutions. The task force then met in early April with ESMA in Paris. At that meeting, ESMA requested ICMA's data quality task force continue to investigate one of the key challenges for the ESMA databases, misclassification of CFI codes (which affect liquidity calibrations). Liz confirmed that additional analysis and further examples were provided to ESMA in response to this request, and that the task force would continue to monitor data quality improvements and engage with ESMA with further examples and recommendations to assist them.

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[3] FIRDS is a data collection infrastructure established by ESMA, in cooperation with EU NCA's. It covers financial instruments that are in scope of MiFID II. This database links data feeds between ESMA, NCAs and approximately 300 trading venues across the European Union.

[4] The 'FITRS' database relies heavily on FIRDS master records for liquidity assessments for bonds subject to the pre- and post-trade transparency requirements in MiFID II.

Two questions were raised by the SMP: (i) did ESMA fully understand the extent of the problem, and (ii) did they have the resources to fix it. The view was that ESMA did have a full understanding of the technical issues and were very focused on addressing the issues, however, it was probably not adequately resourced to manage such a herculean task as administrating the quality and use of MiFID II post-trade data.

3. ICMA's approach to advocacy for a fixed income Consolidate Tape

Discussion

Context

Co-chair, David Camara, introduced the discussion on the notion of a European consolidated tape for fixed income by way of reference to the previous agenda item and noting that ensuring market data quality is an essential prerequisite to that data being meaningful or usable. The next challenge is then accessing that data, commenting that 'it is dark out there'. The current MiFID II market data landscape involves multiple APAs (approved publication arrangements), all of whom present data in non-consistent formats, with different levels of and approaches to accessibility, varying applications of deferrals (up to four weeks in many instances), with question marks over data quality. This creates a circular problem: if nobody is using the data, there is very little incentive to fix the underlying problems.

Currently, any firm that wanted to source MiFID II data for fixed income had a number of options, each with their own challenges, costs, and limitations. One is to scrape APA data and pool this. However, all the APAs use different formats, can be difficult to access, and the data would need be cleaned at the APA level, rather than at aggregate level. Another is to negotiate arrangements with the APAs for them to provide the data directly, but this also comes at a cost. Finally, there is the option of subscribing to data aggregators, but other than cost there is the issue of market scope, with probably only 60% to 70% market coverage.

Regulatory engagement

It was noted that the authorities are beginning to show more interest in the potential for a consolidated tape. In May, ESMA had held a private industry meeting to discuss a consolidated tape for equity markets, in light of the fact that the MiFID regulatory provisions had so far failed to deliver a consolidated tape provider (CTP). Furthermore, DG FISMA was planning to hold a broader industry event on consolidated tape, in which ICMA had already been invited to participate.

The Group was reminded that in 2016, ICMA had mobilized a working group of senior buy-side representatives to respond to the ESMA consultation on consolidate tape for non-equity products. The ICMA response essentially advocated an 'ESMA owned', single source, utility-based tape, providing the most basic 'raw' market data. The proposal further suggested that this could be self-financing.

It was noted, however, that under the regulation, there is no mandate for such an initiative. This would require a change in the regulation – or MiFID III. Furthermore, it would seem unlikely that ESMA would have either the appetite or capacity to oversee a utility-based tape.

Apparently a new ESMA consultation on consolidated tape was expected in the coming weeks. It was agreed that ICMA should respond to this.

Commercial options

It was felt that in the absence of the authorities providing a tape, the options were either for the regulators to provide a commercial incentive for a CTP, or for ESMA to create a consortium or vendors, or commission a single vendor, to provide the tape. The downside, however, based on other market examples of single vendors or consortiums providing key services, is the potential for monopoly powers which create additional costs and risks to the wider market.

ICMA's position

It was suggested that ICMA's role should largely be that of a neutral body, ideally explaining the objectives and benefits of a consolidated tape in order to help direct the discussion toward the optimal outcome. In doing so, it should highlight the importance of quality, universal accessibility, and which data is relevant and sufficient (in particular educating regulators on the difference between bonds and equities, and how meaningful transparency of bond markets requires different data points to that of equity markets).

It was argued that ICMA may need to be quite specific in terms of what constitutes 'raw data', as opposed to enriched date, and that this may be a difficult balancing act in discussions with data vendors. There may also be differences in what various data users want from a consolidated tape, with some being better able or more prepared to pay for enriched data or, more likely, to process it themselves.

ICMA informed the Group that as part of its background work on this topic it was discussing with members and other stakeholders the benefits and challenges of the TRACE model in the US, noting that this seemed to prompt mixed reactions across users. Of particular interest would be the lessons learned with respect to price formation, liquidity, and impacts on data costs. At the very least, a review of the established consolidated tape for the largest corporate bond market in the world should help to inform the European discussion.

The question was raised as to whether it would even be possible for ICMA to formulate a position, given its diverse membership and constituencies. It was proposed that it may be difficult, but a helpful starting point might be for ICMA to consult with its members to garner the various viewpoints and put this into a discussion paper. This in itself would be highly useful for all stakeholders, including the authorities, and could possibly help inform the discussion. It was suggested that ICMA survey its members (perhaps through an online survey) to ascertain their views more systematically. This might also help identify areas of common agreement as well as highlighting some key differences. ICMA may also then be better placed to respond to the projected ESMA consultation in a balanced, neutral, and representative fashion.

Action point: ICMA to consult members (possibly by means of an online survey) to garner views on a potential consolidated tape for European fixed income, and to use this as the basis for a Discussion Paper intended to inform the broader debate.

4. FinTech Update

Briefing

Andy Hill (ICMA), on behalf of Gabriel Callsen (ICMA), provided the Group with a brief update on ICMA's recent activities and initiatives related to FinTech.

As the SMPC had been informed previously, ICMA is a member of the IOSCO FinTech Network which is chaired by the FCA (Chris Woolard, Executive Director of Strategy and Competition and FCA Board member). The purpose of the network is to share information and practices in an informal manner, by exploring the practical application, use cases and jurisdictions' experiences of supervising fintech developments; sharing views on emerging trends, issues and potential risks; focusing on cross-border issues that may require an internationally coordinated response.

Also flagged previously, ICMA is actively contributing to the IOSCO FinTech Distributed Ledger Technology (DLT) workstream, led by the AMF Québec. Other participants include Australia's ASIC, British Columbia Securities Commission, ESMA, Gibraltar Financial Services Commission, Securities and Exchange Organization of Iran (SEO), FCA, Swedish Finansinspektionen, Malta Financial Services Authority, and the SEC. The objective is to develop a series of papers exploring different applications of DLT in securities markets, as well as regulators' real and hypothetical responses. The first paper covers the World Bank's Bond-i issuance from August 2018, where the World Bank issued a 2-year bond using DLT (2.20%; AUD 110 million; AU0000020612; lead manager Commonwealth Bank of Australia). ICMA has contributed by sharing examples of new FinTech applications that it has published on our website. Participants decided that the recent World Bank DLT-based bond issuance is of particular interest, also given ASIC's participation in this workstream, and it was agreed to focus on this use case for the first paper. We have drafted a section on distributed ledger technology for the paper. The final draft was submitted to the IOSCO board ahead of the IOSCO AGM in May.

ICMA has also contributed to the IOSCO FinTech Lessons Learned in Supporting Innovation workstream by sharing its paper on FinTech and innovation in capital markets, notably the classification of innovation support mechanisms to help refine 'innovation support functions' in the survey.

Finally, and again previously reported, ICMA, through the ERCC Ops FinTech WG, is an active member of the ECB's Harmonisation Steering Group's FinTech Task Force. The ECB FinTech Task Force is a technical subgroup of the AMI-SeCo (Advisory Group On Market Infrastructures for Securities And Collateral), which is chaired by Nicholas Hamilton (JPM), who is longstanding co-chair of the ERCC Operations Committee. The AMI-SeCo is an advisory body to the ECB Eurosystem for all issues related to the TARGET2-Securities (T2S) settlement system. ICMA was contributing to this TF by sharing information on ICMA's FinTech work, by contributing to the ECB's mapping exercise of innovative post-trade technology solutions which are based on distributed ledger technology, and by contributing to a paper on tokenization of securities, which focuses on the possible impact on post-trade trade processes.

The SMPC was further reminded that the inaugural ICMA FinTech Forum would be held on June 25 2019, hosted by UBS.

5. European Corporate Bond Secondary Market Study

Briefing

Andy Hill reminded the Group that following SMPC approval at the March 2019 meeting, ICMA was currently undertaking its 3rd study into the sate and evolution of the European IG corporate bond secondary market. As with the previous study in 2016, the research would take a triangular approach of utilizing market data provided by various vendors, asking members to complete online surveys (sell-side and buy-side focused), and conducting a range of semi-structured interviews with a broad range of market participants and stakeholders.

The study specifically sets out to address three key questions:

- What is the current state and expected course for market liquidity?
- How is the structure of the market evolving?
- What are the expectations for future market developments?

The secretariat reported that a number of sell-side and buy-side firms had already completed the online survey (around 20 in total), but arranging interviews was proving to be challenging. Members were encouraged the support the initiative.

6. Other Working Group and workstream updates

ETC

Liz Callaghan (ICMA) briefed the Group that the Electronic Trading Council was currently focused on two key issues in the context of fixed income trading: (i) the distinction between automation and algorithms in the context of fixed; (ii) possible best practice for electronic axe dissemination.

In the case of the former, the previous meeting of the ETC, on March 7 2019, involved a fascinating discussion on the issue involving experts on the subject from two large law firms who were able to add a legal dimension to the regulatory and market perspectives. The plan was to continue this discussion at the next ETC meeting (June 14) with a view to developing an ICMA discussion paper.

The Group was reminded that the next back-to-back meetings of the ETC and MiFID II Data Workstream would be held on June 14, hosted by Tradition, Paris. An agenda for the meetings would be circulated soon.

CSDR-SD

Andy Hill updated the Group that the CSDR-SD Working Group was currently focused on a number of important issues with respect to implementation of the CSDR mandatory buy-in regime, now expected to be in November 2020. In particular, from a cash market perspective, ICMA was still pressing ESMA to provide Level 3 guidance that the apparent asymmetry in the regulatory provisions for settling the buy-in or cash compensation price differential could be addressed by contractual arrangements, such as the

ICMA Secondary Market Rules & Recommendations. ICMA had also agreed to host a cross-industry workshop to discuss the potential design of a pass-on mechanism that could work under the regulatory framework. ICMA had already discussed with ESMA the possibility of a mechanism similar to that currently employed under the ICMA Buy-in Rules, and which would allow for pass-ons to move along a transaction chain which may contain different intended settlement dates. ESMA seemed open to the idea but had asked ICMA and the broader industry to provide a more detailed specification of how such a mechanism could work.

Ultimately, the ICMA Buy-in Rules would be revised to provide both a contractual framework and market best practice for members to comply with the CSDR buy-in requirements.

Brexit TWG

Andy Hill informed the Group that following a suggestion at the inaugural meeting of the ICMA Secondary Market Brexit Technical Working Group on April 11 2019, ICMA had organized a briefing session for cash bond and repo trading venues to update sell-side and buy-side members on their Brexit strategies, as well as to answer any questions. This was scheduled for the morning of June 25 2019, and would be hosted by AXA IM.

7. Important updates and any other business

The ICMA secretariat flagged the recently announced ECB's consultation paper on the European Distribution of Debt Instruments (EDDI) initiative. ICMA intended to respond to the consultation and would request input from its various constituencies. SMPC members were kindly asked that they reach out to their sovereign bond traders to request feedback to help direct and inform the ICMA response.

Discussion

It was noted that the EDDI proposal was fairly ambiguous in what it was trying to achieve: was it more to help facilitate post-trade harmonization as part of the T2S project, or was it focused more on creating a primary issuance platform? This raised important questions about the role of the private and public sectors in driving market efficiencies in the issuance and post-trade processes. Members suggested that this could be a positive initiative, but it also had the potential to be quite disruptive. Ultimately, there was a need for far more clarity as to the primary objectives of EDDI.

There was no other business.

8. Important calendar dates

- ICMA Women's Network: Mental Health in the Workplace, June 5 2019, 17:30-20:30 BST, Freshfields, London
- ICMA ETC/MWD meetings, June 14 2019, 13:00-16:00 CEST, Tradition, Paris
- ICMA Secondary Market Brexit TWG: Trading venue Brexit briefings, June 25 2019, 8:30-11:30 BST, AXA IM, London
- ICMA FinTech Forum: How is technology shaping international fixed income markets? June 25 2019, 13:00-18:00 BST, UBS, London
- Covered Bond Investor Conference 2019, June 27 2019, 09:00-15:10 CEST, Deutsche Nationalbibliothek, Frankfurt

ICMA would confirm the date and venue of the next SMPC meeting soon. This was likely to be held in early September.

Prepared by Andy Hill
July 2019