Secondary Market Practices Committee

Meeting of the ICMA SMPC, March 19th, 2019

The meeting was held at BNP Paribas AM, Paris, and Chaired by Yann Couellan and Sonali Das Theisen

Attendees

In the room:

Yann Couellan	BNP Paribas Asset Management	(Co-chair)
Sonali Das Theisen	BAML	(Co-chair)
Yannig Loyer	AXA IM	
Umberto Menconi	Banca IMI	
Stephen Fisher	BlackRock	
Silas Findley	Citi	
David Camara	Goldman Sachs	
Antony Baldwin	LCH	
Sylvie Bonduelle	Societe Generale	
Godfried De Vidts	ICMA	
Andy Hill	ICMA	(Secretary)
Rene Karsenti	ICMA	
Mathilde Babel	ICMA	

Guests:

William Perraudin	Risk Control
Emma Cervantes	Risk Control

On the line:

Andrew Wallhead	Barclays
Sander Schol	BGC Partners
Brian Lynch	BNY Mellon
Marco Ferrari	EFG Bank
Barbara Zittucro	Intesa San Paulo
Tom Young	Jefferies
Kate Finlayson	JP Morgan
Charlotte Decuyper	Liquidnet
Angela Lobo	Morgan Stanley
Vincent Grandjean	Santander
Matheiu Casadevall	Societe Generale
Leslie Woolaston	Unicredit
Paul Gover	Westpac
Elizabeth Callaghan	ICMA
Lisa Cleary	ICMA
Lee Goss	ICMA

Agenda items

Co- Chairs' welcome

Following the roll-call, Yann Couellan welcomed the SMPC to its first meeting in Paris, noting that once again there was a robust agenda covering a range of highly relevant topics pertinent to the European fixed income markets.

1. Administrative matters: approval of new co-chair

The Secretariat announced that after three years of serving as co-chair of the SMPC, Sonali Theisen would be stepping aside. David Camara of Goldman Sachs had been proposed as the new sell-side co-chair, unless there were any objections from the Committee.

Yann Couellan, on behalf of the SMPC, thanked Sonali for her dedicated and dutiful service, noting that her tenure had covered some key milestones in market development, including the launch of MiFID II/R, the ECB's Corporate Sector Purchase Programme, and the rapid electronification and technological evolution of the secondary bond markets. He further noted David's ongoing commitment and contribution to the SMPC and its various working groups and congratulated him on his position as co-chair.

David Camara will assume the SMPC co-chair immediately following the ICMA AGM in May 2019.

2. MiFID II research unbundling

William Perraudin of Risk Control briefed the Committee on a DG-FISMA initiative to analyze the effects of the MiFID II unbundling rules on investment research. The Commission has given Risk Control the task of assessing the effects of the MiFID II rules on investment research related to fixed income and small cap equities. The project will address four questions: 1. What is the market and legal landscape for European securities research relating to fixed income and small cap equities? 2. How have buy-side research budgets evolved before and after the introduction of MiFID II? 3. What determines the pricing and quality of securities research provided by the sell-side? 4. How have the MiFID II rules affected access to finance for medium sized companies?

To answer these questions, Risk Control will employ a combination of statistical analysis, surveys and structured interviews. The statistical analysis will measure how analyst coverage has changed over time and, in particular, since January 2018. The surveys will be organized, if possible, with the cooperation of the major industry associations for buy-side, sell-side, and independent research providers (IRPs). Interviews will permit an in-depth coverage of issues raised in a more summary way via the surveys.

Risk Control would very much like to engage the SMPC's sell-side and buy-side constituents both to participate in the surveys as well as in the structured interviews.

Discussion

The question was raised as to the choice of timing for the initiative, given that the new research rules have only been in force for little more than a year, which is probably not long enough to notice any real changes or impacts with respect to fixed income and small cap equities. In many cases the new rules were still being adopted and so a study such as this, important and welcomed as it is, seems premature.

Another question was raised about the metrics and measurables being applied in the analysis. Was the study, for instance, intending to look at issuance trends in SME bond and equity markets, or volumes and liquidity in SME secondary markets, to determine whether these were being impacted by the new research rules? It was suggested that observing a reduction in SME research in itself was not necessarily meaningful, rather it was the market impacts and the link with the real economy that were important.

Risk Control noted the SMPC's helpful comments and suggestions, but also explained that the timing and scope for the study had been very much determined by the Commission, and so there was not a great deal of flexibility in these respects.

The SMPC agreed that there was still value in the research and that ICMA should help to support the work by connecting relevant sell-side and buy-side members with Risk Control to take part in the surveys and interviews.

Action point: ICMA to connect SMPC members and other relevant constituents with Risk Control and encourage them to participate in the surveys and interviews

3. ICMA Secondary Market Brexit Technical Working Group

The Secretariat reminded the Committee that the possibility of creating a working group to focus on certain technical aspects Brexit related to secondary bond and repo markets had been discussed at a number of SMPC meetings and at the November 28 2019 meeting it had been agreed that the proposed technical working group (TWG) should be rolled-out as soon as there was more certainty around the timing and nature of the UK's departure from the EU, which was expected to be shortly after the next scheduled meeting of the SMPC (March 2019). While that was not the case, the questions before the SMPC were: (i) Should ICMA go ahead and roll-out the TWG regardless? (ii) What should be the scope, issues, and deliverables for the WG?

Members felt that the TWG should be launched and that waiting for political clarity around Brexit was increasingly irrelevant. Some noted that in many respects Brexit had already happened, and a lot of the technical work already done. In terms of scope, it was suggested that certain issues have commercial sensitivities and that many firms would not want to discuss them openly with their counterparties. It was pointed out that in many cases participants may not want to be on the record discussing Brexit related issues in a public forum, even if the topic matter is relatively immaterial. It was therefore important to identify pressing issues that were largely technical in nature, and not commercial, and that did not raise such sensitivity and where solutions could be achieved by bringing the industry together.

While this may limit the scope, there were almost certainly a number of pertinent areas where the TWG could bring value.

It was suggested that reaching out to interested members for focus areas and potential deliverables could be the best way to launch the TWG. Brexit was going to be a lengthy process, rather than a one-off event, and there would be a long pipeline of possible areas for work running for many years, so in this respect the TWG would be as much about creating the space for ICMA sell-side and buy-side members to raise relevant issues and possible workstreams.

Action point: ICMA to launch a Secondary market Brexit TWG and reach out to interested members for focus areas and potential deliverables.

4. Electronic Trading Council & MiFID Data Workstream updates

Liz Callaghan briefed the Committee on the current initiatives, deliverables, and progress of the various ETC and MDW Task Forces.

The ETC Task Force on 'Axe Distribution' was focused on the various modalities of how axes are distributed for cash bonds and some of the frustrations experienced by the buy-side arising from certain related practices. The objective of the TF is to provide definitions of what constitutes a form of axe distribution and then to explore the possibly for outlining market best practice. It is further intended that any eventual best practice could be included in the ICMA Secondary Market Rules & Recommendations.[1]

The ETC Task Force on 'Algos and Automation' is looking to help address the confusion as to the difference between algorithms and automated processes. This involves not only analyzing the regulatory definitions of algos (eg in MiFID II), but also involving discussions with lawyers and market participants to identify the particular attributes and nuances that might determine the distinction between what is an algo and what is not. The objective here is to produce a discussion paper that could help to inform regulatory considerations around this important distinction.

The MDW Task Force on 'Best Execution' is currently analyzing the various reporting fields under the RTS 27 best execution reporting requirements as they relate to fixed income. The objective is to identify which data fields potentially provide the most value for buy-side firms in their best execution analysis and, if there is an identified need, to establish best practice for reporting with relation to these specific fields. So far, the TF had identified which of the nine RTS reporting templates contained fields that could be useful.

The MDW Task Force on 'Data Quality' has undertaken extensive work and analysis on the various challenges in MiFID II/R post-trade data, particularly those related to the key ESMA databases (FIRDS and FITRS). Furthermore, the TF has outlined detailed solutions to improve the quality of post-trade data and a meeting had been scheduled between the TF and the relevant ESMA experts in Paris on April 2. It

[1] The ICMA SMR&Rs automatically apply to member firms transacting in international securities.

was further hoped that this meeting would the start of ongoing industry engagement with ESMA in order to address the various identified data problems.

The next meetings of the ETC and the MWD would be back-to-back on June 14, hosted by Tradition in Paris.

5. CSDR Settlement Discipline

Andy Hill briefed the Committee on the ongoing work of the ICMA CSDR-Settlement Discipline Working Group with respect to the implementation of the mandatory buy-ins in September 2020.

ICMA recently had a follow-up call with ESMA to discuss the difference payment asymmetry in the buy-in framework and the possibility of addressing this through contractual arrangements, such as the ICMA Buy-in Rules. ESMA had already indicated that this should be possible in the case of buy-ins, subject to European Commission approval, but needed a better understanding of why and how the symmetry would work in the case of cash compensation. ICMA had provided ESMA with further clarification on this point, as well as proposed Q&A wording for addressing both the buy-in and cash compensation difference payment asymmetry and was now awaiting further feedback from ESMA.

ICMA had also designed a proposed pass-on mechanism intended to work under the regulatory framework, that largely replicates how pass-ons work under the ICMA Rules today. It had been widely approved by the CSDR-SD WG, and also shared and discussed with ESMA. ESMA indicated that they were keen to have mechanisms that could provide for pass-ons through a transaction chain and so minimize the number of buy-ins that might be caused by a single failing trade. With respect to the ICMA proposal, ESMA did not suggest that it would not be possible, even though it could potentially extend the effective extension period across a chain, but did state that the critical concerns from their perspective were the ability for (I)CSDs to recognize that there is a pass-on situation, and so no necessity for a buy-in, and assurance that a buy-in will take place at some point and that the pass-on chain does not extend 'out of scope'. The CSDR-SD WG will continue to work on these points, while also engaging with AFME, who are exploring alternative pass-on mechanisms (although these are likely more suited for more liquid instruments such as equities).

Once there is further clarification from ESMA on these and other issues, the intention is to undertake an extensive consultation with members and the broader industry on the updated Buy-in Rules which will aim to align with and support implementation of the CSDR regulatory requirements, both as a contractual framework and market best practice.

Discussion

It was asked whether there was still a possibility that the CSDR buy-in regime might not be implemented, given the damage it would almost certainly inflict on bond market functioning and liquidity. It was also noted that a prominent MEP had stated in a recent ICMA forum that it was now broadly understood by the Commission that "it would not work" and that there was recognition that it would need to be scrapped. The ICMA Secretariat explained that while that was clearly the hope, and that this would be a good outcome for everyone, including the regulators, the working assumption had to be that the mandatory buy-in regime, as potentially disruptive as it is, would go ahead from September 2020, and that industry efforts should remain focused on damage limitation.

The Secretariat was asked if ICMA intended to continue advocacy work to stop the implementation of mandatory buy-ins, given the widely expected detrimental consequences. ICMA reported that the intention was to step-up advocacy work in Q3 of 2019 as part of the CSDR five-year review, but also noted that there was no precedence for the Commission reviewing pieces of regulation that had not yet been implemented. Committee members suggested that any advocacy work should be related to 'Capital Markets Union' given that mandatory buy-ins were in complete contradiction to the objectives of CMU and promoting pan-European market-based finance.

Action point: ICMA to continue advocacy work highlighting the negative impacts of CSDR buy-ins for European bond markets, particularly within the context of CMU.

6. FinTech Update

Given the limitations of time, the Secretariat explained that it would not provide a full briefing on ICMA's extensive FinTech related work this time, but hoped that Gabriel Callsen, who was in the ICMA FinTech lead, would be able to do so at the next meeting of the SMPC. However, for now the Committee should be aware that ICMA is engaging actively with the regulatory community, and cooperating in a number of initiatives, including the IOSCO FinTech Network and the ECB FinTech Task Force.

7. 3rd European Corporate Bond Secondary Market Study

The ICMA Secretariat informed the Committee that in H1 of 2019 it intended to undertake its 3rd study into the state and evolution of the European IG corporate bond secondary market. The previous study had been published in 2016 and it would be helpful to review the state of the market three years on, particularly following the introduction of MiFID II/R and the completion of the ECB's CSPP.

Discussion

Members agreed that a new study would be timely and relevant. It was further proposed that the state of market liquidity should be at the core of the analysis, as anecdotal evidence suggests that this has almost certainly declined further in the three years since the last report. Another suggestion was that it should include an analysis of how technology is impacting the market, such as the introduction of algo treading in credit, as well as the uptake of new trading protocols – for instance, is the market still predominantly structured around 'RFQ'? Data was suggested as a key area of interest, not just in terms of providing quantitative analysis as part of the study, but also identifying data gaps and challenges in sourcing meaningful data.

Other ideas included an overview of the post-trade landscape, such as T2S, and how this was impacting the market, as well as the role of 'processed trades' in moving trading onto venues. Finally, it was recommended that the study take a forward-looking position and that it tries to attain a sense of potential impacts of future regulatory initiatives, such as increased capital costs for trading credit and CSDR mandatory buy-ins.

Action point: ICMA to share Terms of Reference for the 3rd European corporate bond study with the SMPC in the coming weeks.

8. Important calendar dates

Members were reminded that the next day, March 20, ICMA would be holding its inaugural Secondary Market Forum, hosted by Refinitiv, Paris, and that more than 180 attendees had registered. The ICMA AGM and Conference would take place in Stockholm on May 15 to 17, while the ICMA Green Bond Principles and Social Bond Principles AGM and Conference was being held in Frankfurt on June 13. As the Committee had already been informed, the joint meeting of the ETC and MWD would take place in Paris on June 14.

There was no other business.

Approval of the minutes of the last meeting
In the absence of any comments, the minutes from the meeting of November 28 2018 were approved.

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

Prepared by Andy Hill
April 2019