Secondary Market Practices Committee

Meeting of the ICMA SMPC, November 28th, 2018

The meeting was held at ICMA, London, and Chaired by Yann Couellan

Attendees

In the room:

Yann Couellan	BNP Paribas Asset Management	(Co-chair)
Lee Sanders	AXA IM	
Aalok Gupta	BAML	
Matthew Coupe	Barclays	
Juan Blasco	BBVA	
Pablo Fenoll	BBVA	
Sander Schol	BGC Partners	
Brian Lynch	BNY Mellon	
Peter Eisenhardt	ICSA	
Tom Young	Jefferies	
Kate Finlayson	JP Morgan	
Hakan Guney	Nomura	
Koji Nakaya	Nomura	
Josh Masters	Westpac	
Elizabeth Callaghan	ICMA	
Gabriel Callsen	ICMA	
Leland Goss	ICMA	
Andy Hill	ICMA	(Secretary)
Paul Richards	ICMA	(Head of ICMA MPRP)
Martin Scheck	ICMA	(CEO)
Alexander Westphal	ICMA	

Special guests:

Fabio Braga	FCA
Stephen Hanks	FCA

On the line:

Sonali Das Theisen	BAML	(Co-chair)
Martina Ben-Shaul	CIBC	
Fleming Due	Danske Bank	
David Camara	Goldman Sachs	
Barbara Zittucro	Intesa San Paolo	
Andrew Bailey	Nomura	
Sylvie Bonduelle	Societe Generale	
Nicholas Philpott	Standard Chartered	
Johan Wijkstrom	Swedbank	
Alex Sedgwick	T. Rowe Price	
Christoph Hock	Union Investment	
Anton Aziz	Westpac	
Godfried De Vidts		(Chair of ERCC)

Agenda items

Co- Chairs' welcome

The fourth and final SMPC meeting of 2018 was opened with an introduction and welcome from Yann Couellan. On behalf of the SMPC, Yann thanked Stephen Hanks and Fabio Braga of the UK FCA for attending the meeting and participating in a discussion on the impacts and challenges of MiFID II/R for the European bond markets in its first year.

1) MiFID II/R the first year: Discussion with the FCA

By way of introduction and context for the discussion, Andy Hill provided a short overview of the results of ICMA's secondary market survey on the impacts of MiFID II/R, which would form part of a projected ICMA report, *MiFID II/R and the bond markets: the first year,* also covering impacts on primary markets and FICC research.[1]

Discussion

Trade data access and quality

Participants noted that there remained concerns about the quality, and therefore usefulness, of the transparency data for bonds, noting that it seemed to be worse for OTC than venue transactions. The view was that MiFID II transparency was a good project marred by bad data.

It was explained that the problems lay firstly in how the data is provided by venues and APAs (approved publishing arrangements) and secondly in how ESMA is utilizing the data. Initially there were issues with data completeness, and a recognition that national competent authorities (NCAs) were not working with the entire data set.

One member pointed to formatting inconsistencies in data reporting as a root problem. For example, it had not been made clear that where a security does not trade, the trade count field should be completed with a 'zero'. Leaving it blank would otherwise corrupt the data.

It was broadly agreed that many of the data problems were essentially 'teething problems', and that these would be addressed overtime. It was always broadly anticipated that the data quality would not be perfect from the start and that the liquidity and threshold assessments would produce a number of 'false positives'. What was of greater concern to the authorities were the more structural challenges in data reporting and formatting. One SMPC member felt that problems arising from static data as well as the scope of 'submitted to trading on a trading venue' (or 'TOTV') were sizeable and been discussed by the industry for a number of years leading up to MiFID II. They questioned whether the investment to support the data requirements was generating a positive return for the end investor, adding that in many cases it clearly was not. It was suggested that perhaps there needed to be better cooperation

[1] The report was subsequently published on December 6 2018

between the various NCAs and ESMA in developing technical standards for data reporting in order to enhance quality.

The FCA identified two key challenges with data: access and quality. With respect to access, regulators could play an active role in ensuring that APAs and venues reporting pre- and post-trade data are fully compliant with both the requirements and spirit of the regulation, ensuring that public access is not in anyway hindered, and also that the data is made available for an appropriate timeframe. With regards quality, however, while there were measures that the authorities could take to improve the data, there were areas which also required industry effort (noting in particular OTC derivative reporting).

The FCA asked the group whether the different application of reporting deferrals across various jurisdictions was also affecting the quality and usability of post-trade data, questioning if it was correct to apply the maximum deferral period for illiquid securities or large trades. They further asked whether perhaps it would have been better to report prices immediately, and merely defer reporting sizes. Members felt that the appropriate deferral period was very much driven by the underlying security. For instance, reporting a large block of an on-the-run Bund is relatively inconsequential, while reporting a trade in an illiquid corporate bond could have negative repercussions on market liquidity.

One member suggested that the introduction of TRACE[2] in the US had not negatively impacted market liquidity and had led to better price formation. However, they felt that the MiFID model would lead to a 'TRACE by the backdoor', where those firms willing and able to pay for trade data would have access, creating an unlevel playing field. Others agreed that a consolidated tape for European fixed income, provided free of charge as a utility, would be beneficial.

The FCA explained that under the regulation there was a two-step approach to achieving a consolidated tape. Firstly, a consolidated tape was intended to be produced for equities from 2019, and currently it did not look as if this was going to happen. Until the logistical challenges of establishing a consolidated tape for equities were resolved, there seemed little prospect of developing one for bonds.

Rounding up the discussion on trade data quality, Liz Callaghan informed the group that ICMA was currently supporting a workstream, under its MiFID II/R Working Group, dedicated to identifying data problems and proposing solutions, and that it intended to share its output with ESMA in the very near future. It was suggested that ESMA should hold off from proceeding with the next phase of the liquidity assessments until the current data issues had been resolved.

Best execution data

Members suggested that the MiFID II/R best execution public data reporting obligations (RTS 27 and 28) had proven to be a missed opportunity, and that the scale and granularity of the required data was not beneficial either to buy-sides or end investors. One member explained that the problem was not so much accessing the data, but rather what to do with it.

The FCA appreciated that the reporting obligations were extensive, particularly under RTS 27, but asked what data fields the industry did find useful and whether there could be a concerted effort at least to ensure that firms focus on completing these fields in a consistent and usable way.

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[2] FINRA's Trade Reporting And Compliance Engine

Some buy-side members expressed concern that there may be a regulatory expectation for firms to include RTS 27 data in their TCA (transaction cost analysis), noting that TCA is an equity market concept and that assessing best execution for fixed income is very different process with a whole range of other considerations.

One member explained that while they have looked at a number of RTS 27 reports, there is no consistent way in which firms report data, meaning that it no two reports can be compared. What is far more valuable is regular face-to-face meetings with counterparties where it is possible to go into far more meaningful detail.

It was further explained by a buy-side participant that RTS 28 also has limited value, since only some of its funds are MiFID regulated, and therefore only a small percentage of their overall transactions are included in their RTS 28 reports (suggesting around 35% for equities and 20% of bonds). The FCA commented that the RTS 28 also called for additional contextual information to be published alongside the data, and that this was equally important.

Extraterritoriality

Members felt that MiFID II/R had not negatively affected non-EU market liquidity, however, it had created logistical challenges. For example, where an Asian based client leaves an order in a product that needs to be traded on a venue (e.g. a USD swap) and subsequently goes home. Another member explained that managing a joint blotter between the EU and Asia had become a technical 'headache'.

The FCA reported that they had not seen any significant changes or impacts from an extraterritorial perspective, and that they were interested in obtaining more data on the different reporting models used by investment firms.

Research

Patrik Karlsson provided the group with a summary of the results of the ICMA Asset Management and Investors Council (AMIC) second survey on FICC research unbundling (published on November 23 2018).[3]

Buy-side members reported that it was not until the third quarter of the year that firms had established the right equilibrium level for pricing. It was noted that at the start of the year there was huge divergence in sell-side pricing for research, but this had since moved into line. One member added that on average there had been a decline in pricing since January.

Wrapping up

The group thanked the FCA for their engagement in the discussion and asked how it could help support the continued implementation of the regulation to ensure that it achieved its main objectives. It was noted that industry feedback and suggestions were extremely helpful and that members should concentrate on how better to apply the regulatory requirements without having to make near term

[3] See: https://www.icmagroup.org/assets/documents/Regulatory/AMIC/AMIC-FICC-Research-Unbundling-Survey-Results-2018-231118.pdf

changes to the existing regulatory technical standards. It was further suggested that at some point in the future, there may be a little more flexibility under the regime from a UK perspective.

2) Brexit and the secondary bond markets

ICMA reminded the group that it had finalized its report on the impacts and implications of Brexit for the secondary bond markets in early November 2018, and that this had been based on extensive interviews with members. However, given the sensitivity of discussions between members and various authorities, as well as the rapidly evolving political negotiations between the EU27 and UK, it was felt that the paper should not be widely published, and for now it has only been made available to firms that participated in the interviews. The SMPC was further reminded that paper was originally intended to provide a launchpad for a Brexit (Secondary Market) Working Group, something that had been proposed in previous SMPC meetings. Members were asked whether they still felt that the proposed Working Group is relevant and, if so, what are the key issues that it should seek to cover.

Discussion

One member suggested that, until recently, industry discussions related to 'Brexit planning' had been very high level and generic, and usually took place at the CEO level. From this perspective there was little that associations such as ICMA could offer in terms of industry support. However, now that we were getting closer to the realization of the UK's withdrawal from the EU, there was a pressing need for more 'grass roots' industry discussion on the practicalities of the post-Brexit market structure. Firms would need to establish how they would interact with each other and how they can source and provide liquidity one the UK leaves the EU. Also, what this will mean from a MiFID II/R perspective, and the practical considerations of reporting obligations. An industry working group focussed on these issues, engaging the business people whose job it is to manage and coordinate these practicalities would be of great benefit.

ICMA explained that it was very happy to support such a working group, however it was concerned by the recent experience of publishing its white paper which suggested a disconnect within firms between senior management and more 'business facing' personnel. There was a potential risk that while SMPC members may find a Brexit working group useful from a business planning perspective, it may not be well received by the senior management of some firms.

Members felt that while it was not always easy to unpick the politics of Brexit, a technical working group would be helpful. It was suggested that it should be possible to select topics of focus that are not strategically sensitive, but rather provide practical solutions for firms conducting their day-to-day business. In other words, the proposed working group would be operating very much in the 'weeds'. It was added that the members of the working group would be those directly involved in trading, and that the focus would be limited specifically to the functioning and structure of bond markets post-Brexit.

It was agreed that once there was clarity on the timing and possible nature of the UK's withdrawal (hopefully in early 2019), ICMA would approach SMPC members to discuss the structure and focus of the proposed working group.

3) 2019 SMPC priorities

Member were asked to suggest SMPC and ICMA secondary markets priorities and outputs for 2019.

Among the key suggestions members broadly agreed on: market functioning and liquidity; MiFID II/R implementation (particularly with respect to data); the Electronic Trading Council (ETC); developing the Secondary Market Rules and Recommendations; and CSDR Settlement Discipline.

Brexit was proposed as an important addition, particularly from the perspective of how this could impact market functioning and liquidity. The potential implications for MiFID post-trade transparency was suggested as a consideration, as was the likely impact on the systematic internaliser (SI) regime. The IFR (Investment Firms Regulation), particularly the related proposed amendments to MiFIR (Articles 46 and 47) with respect to third country equivalence, was cited as another potential 'game changer' for European bond market liquidity. The impact of the ESA-review on third country equivalence decisions related to trading venues and CSDs was raised as a further Brexit consideration.

It was accordingly agreed that Brexit would need to be a top priority for the SMPC in 2019, from a variety of perspectives and considerations.

4) Secondary Markets Forum

ICMA informed the SMPC that its inaugural Secondary Markets Forum would be held in Paris on the afternoon of March 20 2019, hosted by Thomson Reuters. It would be an open event designed to showcase ICMA's extensive secondary market work and reach and would seek to engage a broad range of bond market participants and relevant stakeholders. It was hoped that Robert Ophèle, Chair of the AMF, would provide a key note address, and the plan was to hold two panel discussions. Furthermore, ICMA was hoping that some of the SMPC members themselves would make themselves available as panelists. The SMPC secretariat would reach out to SMPC and working group members soon to discuss topics and panelists.

5) Important dates

Apart from the Secondary Markets Forum on March 20, the next meeting of the SMPC is scheduled for March 19 2019, also, in Paris, and will be hosted by BNP Paribas AM. More details would be provided soon.

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 September 19 2018 were approved.

The next meeting will take place on March 19 2019, hosted by BNP Paribas AM in Paris.

Prepared by: Andy Hill
December 2018