# Secondary Market Practices Committee

# Meeting of the ICMA SMPC, May 3rd, 2018

**The meeting was held at Citi, London, and Chaired by Yann Couellan, BNP Paribas AM**

**Attendees**

*In the room:*

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| Yann Couellan | BNP Paribas AM | (Co-chair) |
| Umberto Menconi | Banca IMI | |
| Daniel Mayston | BlackRock | |
| Silas Findley | Citi | |
| Ashlin Kohler | Citi | |
| David Camara | Goldman Sachs | |
| Anthony Baldwin | LCH | |
| Gareth Coltman | Market Axess | |
| David Zahari | Morgan Stanley | |
| Andrew Bowley | Nomura | |
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| Elizabeth Callaghan | ICMA | |
| Gabriel Callsen | ICMA | |
| Leland Goss | ICMA | |
| Andy Hill | ICMA | (Secretary) |
| Martin Scheck | ICMA | (CEO) |
| Paul Richards | ICMA | (Head of ICMA MPRP) |

*Video-link:*

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| Sonali Das Theisen | Citi | (Co-chair) |

*On the line:*

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| Eckard Ulbrich | Alliance GI |
| Philip Cramp | BGC |
| Martina Ben-Shaul | CIBC |
| Barbara Zittucro | Intesa San Paolo |
| Andrew Mosson | JP Morgan |
| Oliver Clark | MTS |
| Michael Kuen | RB International |
| Ricardo Goddard | Schroders |
| Mathieu Casadevall | Société Générale |
| Stephanie Elford | Swedbank |
| Alex Sedgwick | T. Rowe Price |
| Paul Gover | Westpac |

## Agenda items

### Co- Chairs' welcome

The second SMPC meeting of 2018 was opened with an introduction and welcome from Yann Couellan, who ran through the packed and diverse agenda. Sonali Das Theisen sent her apologies for not being able to join all of the meeting but would join by video-link for as much of it as possible.

### Approval of the minutes of the last meeting

In the absence of any comments, the minutes from the meeting of February 6th 2018 were approved.

### 1) MiFID II/R post-implementation

Briefing and discussion

*Roundtable update*

The ICMA Secretariat highlighted the key MiFID II implementation topics coming out of member roundtables held in Copenhagen, London, and Vienna since January 3 2018. It was noted that from a market stability and liquidity perspective, "nothing had crashed", however, a number of challenges faced market participants. Top of the list is pre- and post-trade data harmonization, or rather the lack of it. Another priority issue is best execution reporting under RTS 28,[1] in particular the qualitative reporting requirements. Booking models and the implications for reporting, particularly from an extraterritorial perspective, is something that has been raised by the FCA. They have asked ICMA, along with AFME and ISDA, to help on this issue, and a meeting has been planned for June 15 when joint members of the three associations will discuss with the FCA the mechanics of booking models in relation to firms' individual business and entity structures.

*Liquidity assessments*

The latest ESMA liquidity assessments for bonds (only 220 assessed to be liquid) was raised. SMPC members made the point that it was not so much the fact that it was a short list that was particularly surprising, more the bonds that are on the list. One member suggested that only one of the bonds was truly liquid, and that it was largely a random list that did not reflect liquidity. Another member stated that the focus of ESMA should not be on the number of ISINs, but on ensuring that they are the right ISINs. It was stated that platforms provide a far better indication than the ESMA assessments of which instruments are liquid.

*Best ex*

It was recommended that RTS 28 is something ICMA should try to get on top of, as the regulators are keen to know how best execution reporting is working out, how meaningful is the data being reported, and what value this brings, both to buy-side and sell-side firms.

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[1] RTS 28 requires investment firms to publish their top five trading venues over the past year for each asset class, with the deadline for the first reports at the end of April 2018

*Cross-border booking models*

The importance of cross-border booking models was picked-up on, particularly as this impacts the quality of reported data (either double reporting or missed reporting), and so the meeting with the FCA was highly relevant. Related to this it seemed as if the FCA was particularly focused on the role of riskless intermediation, but this was more significant in the context of equity crossing networks, and not especially meaningful for fixed income markets. It was further noted that Brexit would further complicate cross-jurisdictional booking models.

*Feedback to ESMA*

In terms of the feedback that ICMA should be providing ESMA, it was felt that data quality and accessibility was the top priority. Data quality not only had knock-on implications for the value of transparency, but also for the calculation of thresholds for deferrals as well as systematic internaliser (SI) determinations. One member stated that the cost of complying with the data reporting requirements has been vast, so it was reasonable to expect some tangible benefits in return.

*Consolidated tape*

Another suggestion was that ICMA should revive its efforts to push for a consolidated tape for fixed income. The secretariat commented that this was very much a 'Level 1' issue, and that advocacy should be directed at the European Commission. ICMA's response to the 2016 ESMA consultation on consolidate tape providers (CTPs) was raised with a view to bringing this to the attention of the European Commission, particularly as it also provided a potentially self-funding model for a single consolidate tape provide by ESMA. It was agreed that the original suggestion should be shared with the SMPC for any possible refinement, but it was felt that in principle this could not hurt. However, it was also noted that the cost of providing a consolidated tape was not the critical consideration, rather it was the quality of the aggregated data. The possibility of a commercial solution eventually emerging was raised, but it was felt that this would require a huge amount of resources. Members were agreed on the need for consolidated data but seemed unresolved on possible solutions.

*Extraterritorial impacts*

The Secretariat provided a high-level update of the feedback from its recent roundtables and meetings in the APAC region. While global firms seemed to be on top of MiFID II implementation, it was noted that was still a fair degree of confusion among more regionally focused entities. Priority concerns included signing new terms of business with MiFID regulated counterparties, the necessity to provide LEIs (and what would happen after June 2018), data requests from MiFID regulated firms and venues, distributing research into the EU, and selling new issues to EU clients. Furthermore, regional firms are aware that this could also have potential impacts on local regulation as regional regulators monitor the roll-out of MiFID II, particularly with respect to regulatory transaction reporting, trade transparency, and best execution policies.

One member agreed that these concerns were consistent with their interaction with regional clients. They added that the confusion around whether research should be chargeable is a particular problem, nothing that this has not yet been resolved in some European jurisdictions. Transparency was another problem, and there was still confusion around the nexus trigger for reporting: was this the product, or the location of the client, salesperson, or trader? They added that this becomes even more difficult for derivatives trading.

*Systematic internalisers*

A point was raised with respect to the SI regime, suggesting that there had not been any notable impact. Despite many banks opting-in to be multi-instrument SIs ahead of January 3, buy-side firms were largely indifferent as to whether they traded with SIs.

***Action point: The ICMA secretariat to circulate the 2016 MiFID Work Group proposal for a self-funded Consolidate Tape, with a view to refining it as the basis of a potential advocacy project.***

**2) MiFID II Trading suspensions**
Discussion and proposal

David Zahari (Morgan Stanley) introduced a potential market efficiency issue arising from MiFID II related to trading suspensions. Articles 32 and 52 of MiFID II provide that if a bond is suspended from trading on a regulated market, MTF, or OTF, for reasons of suspected market abuse, a takeover bid, or non-disclosure of inside information about the issuer or bond, the relevant NCA must require all RMs, MTFs, OTFs, and systematic internalisers under its jurisdiction also to suspend trading in that bond. This creates potential problems for investors seeking to source liquidity for bonds that become stressed or subject to certain corporate actions, and where market-makers or active liquidity providers for those bonds (likely to be SIs) are suspended from trading in them. In turn, this could also have important risk implications for liquidity providers, who may be unable to manage their exposures in the event of a suspension.

One possible solution in the short-term could be for SIs to opt-out from their SI status for any affected bonds. However, this would be more problematic after September 2018 when SI status would be based on historical trading activity.

An example of the potential ramifications is Novo Banca, whose bonds were suspended by the Luxembourg Stock Exchange in 2017 as it became clear that the bank was in trouble. Investors holding Novo Banca bonds were still able to trade out of their positions since these continued to trade actively in the OTC secondary market (there would have been virtually no trading on the Luxembourg Stock Exchange). However, in a similar scenario, under MiFID II, this might not have been possible.

Importantly, however, Article 52 also provides that NCA's have the discretion not to impose a suspension 'where such suspension or removal could cause significant damage to the investors' interests or the orderly functioning of the market'.

It was agreed that while changing the Level 1 text would be significantly challenging, the provision for NCAs to exercise discretion as to whether to impose a suspension should be the focal point of any advocacy work. It was suggested that the ICMA secretariat, in cooperation with Morgan Stanley and other SMCP members, draft a Position Paper outlining the importance of maintaining secondary market liquidity for bonds that may be distressed or subject to certain corporate actions in order to protect investors and to preserve market stability. This would be aimed at flagging the importance to NCAs across the EU28, and would be educational in its approach. It was also agreed that buy-side support would be important, since it is they that are most significantly impacted in these scenarios, and that the SMPC would seek to liaise with ICMA's Asset Management and Investors Council (AMIC) in finalizing the paper.

***Action point: The ICMA secretariat, in coordination with the SMPC and AMIC, to draft an educational position paper on MiFID II trading suspensions aimed at EU28 NCAs.***

**3) Electronic Trading Council update**

Briefing and discussion

The ICMA Secretariat provided a briefing on the inaugural meeting of the newly formed Electronic Trading Council (ETC), held at T. Rowe Price on April 18 2018. Members (many of whom had attended that meeting) were informed that the launch had been hugely successful, and that more than 60 participants packed into the room, with over 20 more dialing-in. It was explained that the ETC combined the existing Electronic Trading Working Group and Platform Working Group, and its objective is to provide a centralized platform for interactive dialogue for relevant fixed income trading participants and trading enablers to identify and document where appropriate, best practice and/or recommended standards. Members of the ETC are buy-side heads of trading desks, sell-side senior traders or heads of market structure and/or electronic trading, and senior representatives from trading venues and technology providers. Accordingly, there co-chairs had been selected, representing each of the main constituents. Furthermore, it now seemed as if a steering committee ('Steer-Co') of core members across the three constituent groups would also be established.

The co-chairs, all of whom were present or dialing-in to the SMPC, were invited to outline their expectations for the ETC. Individual objectives for the forum included: standardized data to support transaction cost analysis (TCA), helping to eradicate confusion around MiFID II requirements, standardizing electronic trading protocols, tracking (electronic) market structure evolution, and promoting the facilitation of a consolidated tape. It was added that so far MiFID II had disappointed, but implementation was a long journey and therefore it was important to have an industry working group that looked to the future and focused on ongoing market evolution.

The ETC Secretariat updated the SMPC on the discussions from the first meeting. There had been a lot of interest in the quality and accessibility of MiFID II pre- and post-trade data and many had expressed interest in a harmonized reporting regime across APAs (authorized publication arrangement). The potential extraterritorial impacts for data reporting was also raised, in particular Brexit related issues. Reviving trading platform presentations, which had been very popular in 2016, would also be an objective, extending the universe of technology solutions, including OMS (order management systems) and EMS (execution management systems).

The possibility for ETC advocacy was raised by an SMPC member, noting that from a buy-side perspective there were concerns around cost and connectivity of various trading platforms and e-solutions, and that there was a need for greater infrastructure standardization to support 'plug-and-play'. It was suggested by the SMPC Secretariat that relevant advocacy was in scope of the (draft) ETC Terms of Reference, but that this would need to be coordinated via the SMPC.

ICMA's senior management commented that some of the issues arising out of the ETC meeting, while critically important, seemed to be much broader than the intended focus of the ETC. It was pointed out that while the SMPC was the overarching forum for secondary market related issues, the ETC was intended to focus on developments in and issues specifically related to electronic trading and related protocols. It was therefore important for the SMPC and ETC to be aware of their remits and parameters, as well as those of other SMPC working groups, such as the MiFID II Working Group, and to allocate the various workstreams appropriately. This would ensure that the right expertise is focused on the right issues and would also help avoid overlap and repetition. Thus, good communication between the ETC and the SMPC was essential. It was further proposed by the Secretariat that regular calls be set up between the SMPC and ETC co-chairs, with the first call taking place soon.

***Action point: The ICMA secretariat to facilitate regular calls between the SMPC and ETC co-chairs, with the first call to take place imminently.***

**4) CSDR Mandatory Buy-ins**
Discussion

The Secretariat informed the SMPC that despite being put on hold since February 2016, there were now indications that the European Commission was finally going to accept the draft regulatory technical standards (RTS) for CSDR mandatory buy-ins. The implication for this was that following European Council and Parliament approval, the regime could come into force sometime in 2020. As well documented and broadly understood, this would have significant detrimental impacts for European fixed income markets, particularly for less liquid asset classes such as corporate bonds and emerging markets, with the likely outcome that these will become 'long only' markets. Members were asked what they thought the SMPC should do in terms of both advocacy and market preparation for implementation.

Members noted that it would be important to engage the buy-side, since it would ultimately be investors who paid the cost of the regime, through worse pricing and lower liquidity. It was also pointed out that the worst-case scenario was that dealers would simply not show offers in bonds unless they held those bonds. Furthermore, even being long requested securities would be enough, and that to ensure guaranteed delivery, positions would need to be in the dealer's 'box' – i.e. prefunded and not loaned out.

It was suggested that ICMA should look to work more closely with the repo community, particularly for credit repo, to develop improved infrastructure and more efficient electronic platforms to facilitate lending, as this would be critical if corporate bond markets were to continue to function in a post-mandatory buy-in world. However, it was also noted that even with improved lending infrastructure, mandatory buy-ins created a disincentive to lending securities, particularly for less liquid bonds.

The Secretariat proposed the creation of a new Working Group to focus on CSDR Settlement Discipline implementation issues and related advocacy. This was agreed, and the consensus view was that ICMA had a duty to continue educating regulators and policy makers of the unintended consequences of mandatory buy-ins, and to "keep shouting", particularly from a buy-side perspective, as it was they who were most at risk.

***Action point: The SMPC to form a new Working Group focused on CSDR-SD implementation and related advocacy.***

## 5) Benchmark reform

Briefing

ICMA updated the SMPC on its extensive work and interaction in the ongoing reform of risk-free reference rates. The group was informed that Risk-Free Rate Working Groups have been set up in all the five main IBOR jurisdictions. ICMA is involved in the Risk-Free Rate Working Group in the UK (working with the FCA and the Bank of England); the Euro Risk-Free Rate Working Group (organized by the ECB, ESMA, the European Commission and the FSMA); and the Swiss National Working Group (chaired by the Swiss National Bank and ZKB). It was also recognized by the authorities that cash markets would be impacted by the transition from IBORs, and that there was a need to engage with relevant stakeholders. In the UK, for example, new Sub-Groups have been formed to cover loans – chaired by LMA – and bonds, chaired by ICMA. The Bond Market Sub-Group is representative of the sterling bond market as a whole, including public sector, corporate sector and financial sector issuers, asset managers and investors, banks involved in the primary and secondary markets, four law firms (working together), and trade associations with an interest, with the FCA and Bank of England providing the Secretariat.

It was explained that Considerable progress is already being made towards the adoption of risk-free rates in the derivatives market, starting with the choice of overnight risk-free rates. Adoption of risk-free rates represents a challenge in the cash markets. The bond market currently references term LIBOR, with a floating rate which is normally reset for periods of three or six months in advance. Potential replacement options include a forward-looking rate derived from the RFR replacement (SONIA in the case of sterling), a backward looking RFR based on the compounded overnight rate, or a choice between the two.

In the meantime, new bonds are still being issued referencing LIBOR with maturities beyond the end of 2021 (i.e. the date after which the availability of LIBOR is no longer guaranteed). If LIBOR is no longer available, the documentation for most existing FRNs specifies that the interest rate would become fixed at the most recent LIBOR rate for the issue concerned, unless new provisions were included specifically about the cessation of LIBOR. This fixed rate fall-back was originally designed in case LIBOR was temporarily unavailable. It was not designed with a view to the permanent cessation of LIBOR.

The forum agreed that there was not enough awareness across the market on the implications of benchmark reform for bond markets, and that ICMA had an educational role to play. It was suggested that ICMA/SMPC organize related events or use opportunities to raise market awareness (it was noted that at the upcoming ICMA AGM, there would be a panel discussion dedicated specifically to this topic).

## 6) Secondary Market Rules and Recommendations

Discussion and approval

The SMPC Secretariat informed the SMPC that it was currently in the process of reviewing and potentially revising the ICMA Secondary Market Rules and Recommendations (SMR&Rs) in light of evolving market structure and dynamics, as well as new regulation. While this would ideally involve member consultation and input, it was highlighted that this was not necessarily forthcoming, as had been the case with the items tabled for discussion on the agenda for this meeting. It was also apparent that the SMPC meetings were perhaps not the right forum for these discussions. Therefore, the proposal was to create a specific SMPC working group that could engage the appropriate experts across trading, operations, risk management, and compliance who had a vested interest in ensuring that the SMR&Rs continued to provide best practice to support efficient and functional secondary bond markets.

Members agreed that this seemed to be the optimal approach and agreed to provide expertise and support from their respective firms.

***Action point: The SMPC to form a new Working Group focused on reviewing and revising the ICMA SMR&Rs.***

**7) ECB Corporate Sector Purchase Programme**
**Discussion**

The SMPC members felt that it would be useful to have another face-to-face discussion with the ECB with respect to the implementation of the CSPP, and in particular with a view to winding this down in the coming months. It was further noted that the impacts of the SMPC went beyond eligible bonds, and there were concerns around the risk-transfer effects into non-eligible bonds, in particular high yield. Members who had attended the previous two SMPC sessions with the ECB noted how helpful it had been for both sell-side and buy-side participants to engage directly and agreed that the ECB should be invited to join the next meeting of the SMPC (expected to be in September).

***Action point: ICMA to invite the ECB to attend the next meeting of the SMPC to discuss the CSPP.***

**8) Brexit**
Discussion

The ICMA Secretariat explained that there was no particular 'Brexit related' issues it wished to raise, but rather there was a general initiative of ICMA to keep Brexit on the agenda for its various committees so that the door remained open for any relevant points or practical issues that members wished to raise.

It was pointed out that Brexit could potentially have serious ramifications with respect to the implementation of a number of important pan-European regulatory initiatives, not least EMIR, MiFIR, and CSDR, particularly if the UK were to transition to third-country status. These impacts were not only relevant to the UK, but also to the EU27. In the context of MiFID II/R, it was noted that this had important consequences for both transparency reporting and thresholds, as well as the SI calculations. Other potential issues related to UCITS and possible restrictions on fund management delegation arrangements.

It was highlighted that the ECB and Bank of England had recently created a technical working group focused on managing Brexit related risks to financial services. Recognized risks included the potential of a 'cliff effect' following the expected transition period to the end of 2020, operational issues related to relocation, and the potentially herculean task of repapering contracts.

Members discussed the possibility of facilitating meetings with relevant regulators and authorities to discuss prospective secondary bond market related issues. However, it was felt that at the moment there was too much uncertainty to underpin any meaningful discussion. Rather, it may be better for the industry to identify and articulate its key concerns and potential challenges to the authorities.

This prompted the question of whether an SMPC Brexit Working Group should be created, noting that a Brexit Working Group had been proposed under the ETC remit, but its scope and focus was considered too broad to fit into the ETC structure. It was also suggested that generally the market facing staff at SMPC member firms are not Brexit experts and are not directly involved in managing the very specific business risks that Brexit potentially poses. Therefore, it would be necessary to find the right people to participate in the proposed Working Group, which may not be straight forward. A further recommendation was that it would be important, and helpful, to begin by mapping what existing Brexit related initiatives were being undertaken by market trade associations, to avoid duplication and to identify where ICMA could provide value.

It was agreed that the SMPC Secretariat would follow-up with interested SMPC members bilaterally to ascertain better the feasibility and potential scope of a Brexit Working Group.

## 9) Any other business

A member raised a question about the recent FCA Consultation on Industry Codes of Conduct, and asked whether this was something ICMA had engaged with or responded to. ICMA confirmed that they had responded to the consultation on behalf of its membership, noting that the consultation focused on unregulated markets, whereas the markets covered by ICMA were regulated. ICMA therefore did not expect the FCA to reach into market segments that were already recognized as being well regulated.

***Andy Hill, on behalf of the co-chairs, thanked all those in the room and on the call for participating and closed the meet.***

Prepared by: Andy Hill
May 2018