Secondary Market Practices Committee

Meeting of the ICMA SMPC, September 19th, 2018

The meeting was held at BAML, London, and Chaired by Sonali Das Theisen

Attendees

In the room:

Sonali Das Theisen	BAML	(Co-chair)
Martin Waryniak	BAML	
Domingo Puertas Trillo	BNP Paribas	
Silas Findley	Citi	
Michael Jezek	Deutsche Bank	
David Camara	Goldman Sachs	
Yilin Koh	Goldman Sachs	
Peter Eisenhardt	ICSA	
Anthony Baldwin	LCH Ltd	
Hakan Guney	Nomura	
Koji Nakaya	Nomura	
Vincent Grandjean	Santander	
Ricardo Goddard	Schroders	
Pasi Hyttinen	Vanguard	
Elizabeth Callaghan	ICMA	
Gabriel Callsen	ICMA	
Leland Goss	ICMA	
Andy Hill	ICMA	(Secretary)
Paul Richards	ICMA	(Head of ICMA MPRP)
Martin Scheck	ICMA	(CEO)

Guest speaker:

Jurian Hoondert	ECB	

On the line:

Ruud Teeuwen	ABN Amro	
Umberto Menconi	Banca IMI	
Philip Cramp	BGC	
Marco Ferrari	EFG Bank	
Barbara Zittucro	Intesa San Paolo	
Julien Morris	Jefferies	
Kate Finlayson	JP Morgan	
Neelam Saini	JP Morgan	
Angela Lobo	Morgan Stanley	
Godfried De Vidts	Nex	(Chair of ERCC)
Sylvie Bonduelle	Societe Generale	
Nicholas Philpott	Standard Chartered	
Victoria Webster	AFME	(Observer)
Patrik Karlsson	ICMA	

Agenda items

Co- Chairs' welcome

The third SMPC meeting of 2018 was opened with an introduction and welcome from Sonali Das Theisen, who commented on the breadth and diversity of the agenda. On behalf of the SMPC, Sonali thanked Jurian Hoondert of the ECB for generously agreeing to join the meeting to discuss developments and the future of the CSPP, noting the ongoing constructive and helpful interaction between the ECB and the SMPC.

1) Corporate Sector Purchase Programme: Presentation and discussion with Jurian Hoondert of the ECB CSPP Team

Jurian Hoondert provided the Committee with an overview of the CSPP implementation to date and market developments. Thereafter the group discussed market considerations related to the anticipated end of APP net purchases. The main takeaways from the publicly available data included:

- To date, €166bn of purchases (book value) were held under the CSPP, consisting of 1,156 different bonds, over 250 different issuers, and 20 countries of risk.
- Net issuance has remained positive since the launch of the CSPP, and the ECB will monitor how this will develop once the APP stops its net purchases.
- Investor demand for new issues has remained relatively stable since the launch of the CSPP.
- CSPP net purchase volumes have varied from time to time and reflect, among other factors, the prevailing market conditions.
- The Governing Council announced that APP purchases were anticipated to decrease to €15bn per month from September and end after December, subject to incoming data. However, principal payments of APP holdings are intended to be reinvested for an extended period of time.
- The details of the re-investment policy still need to be discussed and approved by the Governing Council.

Discussion

It was noted by one member that the breakdown between primary and secondary purchases (17.5% vs 82.5% as of August 2018) was, in reality, skewed since many of the secondary market purchases would have been of recently issued bonds, particularly as most secondary market liquidity is in the first few days following a bond's issuance. They further commented that in the near-term redemptions remain low, which also takes the pressure of the secondary market.

A question was raised as to whether high yield issues that are upgraded to investment grade could be included in the pool of purchasable assets, which was confirmed, as long as the other eligibility criteria are also met.

One member suggested that during recent episodes of market volatility, the programme had provided a 'back stop' bid to support market and wondered how the market may react in the future, once the CSPP had stopped. It was felt that so far the corporate bond market had taken the anticipated end of the APP net purchase phase well, partly due to advanced communication, while it was also arguable that compared to the US market, investment grade spreads still appeared to present value.

The Committee discussed whether the CSPP could be considered a success. It was noted that corporates have been able to access cheaper financing since the programme was announced, and new issuance volumes have been buoyant, but it was difficult to attribute causality, since one could not know the counterfactual. However, it can be observed that credit spreads tightened noticeable in reaction to the original announcement and 20% is a significant share of the eligible market and would almost certainly impact spreads. Furthermore, the impact may be easier to discern from the high yield market, which has seen spread tightening as a result of portfolio rebalancing ('the search for yield') as well as increased issuance and new issuers coming to market.

Members felt that going forward it would be interesting to see how the compression of high yield and investment grade spreads performed without ECB intervention, particularly in the case that default rates were to increase. New issuance levels would also be a telling ex-post indicator of the impact of the CSPP.

2) Brexit and European secondary bond markets

Update and discussion

Andy Hill updated the Committee on the progress of ICMA's project white paper on Brexit and the European secondary bond markets.

The idea to write a paper focused on impacts and considerations for European secondary bond and repo markets related to Brexit had been raised and discussed at the May SMPC meeting.[1] The SMPC felt that it would be germane to produce a paper that explored the views, concerns, assumptions, as well as plans, of member firms active in the European bond and repo[2] markets. The objective would be to help provide market intelligence and awareness for investment firms grappling with the potential market outcomes and structural changes resulting from Brexit, as well as alerting the relevant authorities to the current and rapidly evolving realities for Europe's debt capital markets; something that has largely been unaddressed in the political discourse to date.

Andy informed the Committee that interviews were well underway. Interviewees included representatives from investment banks (broker-dealers), asset managers and investment funds, as well as electronic trading venues, and covered firms based both in the EU27 / EEA and the UK. The interviewees are a broad range of market professionals, including traders, fund managers, market structure experts, legal and compliance, and business managers. ICMA was aiming to conduct a minimum of 20 interviews by the end of September, with a view to publishing in mid-to-late October.

[1] See: https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/ICMA_SMPC_Minutes_May-3-2018-280918.pdf

[2] The SMPC also acknowledged the support and input of European Repo and Collateral Committee in producing this paper.

Discussion

Committee members broadly agreed that the paper was a good idea and that it could be useful for many market participants as well as the authorities. Even if it did not report anything particularly new, it would be helpful to have all the key issues consolidated and discussed in one document.

Members commented that one of the single biggest challenges was planning amidst so much uncertainty and trying to anticipate optimal post-Brexit business models. It was noted that as a result Brexit was already happening, and that many firms, particularly banks and trading venues, were well into the process of preparing to locate parts of their fixed income businesses from London to an EU27 centre. One member suggested that in many ways we had already passed the point of no return, and that some firms relocating businesses were already indicating that they would not be 'coming back', regardless of any eventual political deal.

As for buy-sides, members explained that the implications were less clear, and that asset managers located in both the UK and the EU27 were looking to their various banks/broker-dealers for guidance on business continuity post-Brexit and whether this would involve repapering with new EU27 entities.

A point was made with respect to the relocation of trading venues to the EU27 and the fragmentation of business across EU27 and non-EU27 platforms. In particular, it does not appear possible for US or LATAM based entities to access EU27 regulated venues, which could have implications for liquidity in emerging markets.

The Committee was also reminded of ICMA's extensive work related to Brexit, including the open letter to senior political leaders in the EU27 and UK of June 2018, which highlighted the cliff-edge risks for capital markets once passporting rights between the UK and EU27 cease.[3] Furthermore, ICMA was currently preparing a new paper on cliff-edge risks in international capital markets which would be published in the October Quarterly Report.[4] These and other Brexit related publications and resources could be found on ICMA's dedicated [Brexit webpage].

SMPC members whose firms had not already committed to participating in the interviews for the white paper on secondary bond and repo market impacts were encouraged to do so.

3) Electronic Trading Council and MiFID II/R Data workstreams

Update and discussion

Liz Callaghan explained to the Committee how ICMA had decided to split-out its work related to bind market electronification and MiFID II/R data into two distinct, but complementary workstreams.

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[3] See: https://www.icmagroup.org/assets/documents/Regulatory/Brexit/Brexit---ICMA-letter-on-Cliff-Edge-Risks-dd-220618.pdf

[4] See: https://www.icmagroup.org/assets/documents/Regulatory/Quarterly_Reports/Articles/Q4-2018-article---Brexit---cliff-edge-risks-in-international-capital-markets-101018.pdf

The Electronic Trading Council (ETC) focuses primarily on bond market electronic trading and automation (e.g. algos, axe dissemination, streaming of quotes, etc.), while the MiFID II/R Data Workstream (MDW) is concerned with data availability and usability, taking into account quality, scope, delivery, ownership and rights, aggregation and use, with MiFID II/R data reporting requirements at its core. The primary purpose of the ETC and the MDW is to identify and document where appropriate, best practice and/or recommended standards for cash bond trading market structure, intended to support the ongoing development of Europe's bond market structure, while also providing a formal, centralized platform for interactive dialogue for relevant fixed income trading participants and trading enablers.

The membership of both groups consists of 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. Priorities and deliverables are determined by established Steering Committees (made up of a representative cross-section of workstream representatives), and once deliverables are established, these are championed by nominated Task Force Leaders (also members), who are responsible for driving the outputs within the agreed timelines.

Liz outlined a number of the agreed tasks and deliverables with which the groups were currently engaged. For the ETC include a range of position paper outlining the differences between e-trading and automation, and proposed market best practice for algo trading in fixed income and electronic axe dissemination. Meanwhile, the MWD has committed to publishing position papers and establishing market best practice for MiFID II/R RTS 27 and 28 best execution reporting, as well as for pre- and post-trade transparency reporting.

Discussion

A Committee member flagged the fact that the FICC Market Standards Board (FMSB) had published draft best practice guidelines for algo trading in fixed income (Algorithmic Trading In FICC Markets Statement of Good Practice Transparency Draft),[5] the consultation period for which had recently ended. ICMA stated that it would look to invite the FMSB to the next meeting of the ETC to present on and discuss its Good Practice.

Members also expressed interest in the ETC workstream related to axe dissemination, suggesting that some firms clearly used axe lists as a means of 'fishing' for flow, and that not all axes were genuine interests. This was also a contributing factor in the more general issue of 'false liquidity', which as well as being a frustration for buy-side firms was also confusing regulators into thinking that market conditions were much better than the reality.

They felt that best practice for this would be helpful but wondered about enforceability. It was explained that once any market best practice was agreed, the next step would be to put this on the agenda of the ICMA Secondary Market Rules and Recommendations Working Group, before being approved by the SMPC and the ICMA Executive Committee. It would then be included in the ICMA Secondary Market Rules and Recommendations which underpin the terms of trading between members in international securities. It was further requested that any best practice with respect to axe dissemination also apply to OTC as well as on-venue.

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[5] See: https://fmsb.com/wp-content/uploads/2018/07/Algorithmic-Trading_SGP_TD_v12.pdf

Action point: The FMSB be invited to join a meeting of the ETC to discuss their Statement of Good Practice for Algo Trading in FICC Markets

Action point: Best practice for axe dissemination also to include OTC

4) CSDR Settlement Discipline

Update

Andy Hill informed the Committee members that on July 24 the ICMA secretariat, including the legal team, met with ESMA's CSDR-SD team, along with the Head of Markets, to discuss the possibility of updating the ICMA Buy-in Rules to align with the CSDR mandatory buy-in provisions, but also to provide a contractual solution for the asymmetry problem. Andy reminded members that as a result of what appears to be a drafting error in the Level 1 text, CSDR buy-ins only allow for the settlement of the buy-in, or cash compensation, price differential to be paid in one direction; that is, from the seller to the purchaser in the event that the buy-in or cash compensation reference price is higher than the original trade price. This asymmetry creates additional risks, not only for sellers of securities, but, indirectly, also for lenders of securities. Andy explained that ESMA fully understood the issue and were happy to work with the industry to find pragmatic solutions.

The next step would be for ESMA to discuss the ICMA proposal with the various NCAs at the next meeting of the ESMA CSDR-SD Task Force in October. The optimal outcome would be for full NCA an also European Commission support, which could then lead to formal guidance in the Level 3 Q&As. However, this was still some way off, and might also require ICMA seeking external legal counsel to ensure that the ICMA Rules had legal enforceability.

Andy also informed members that ICMA had recently published two papers on CSDR mandatory buy-ins, one an information brochure[6] to help promote awareness of the scope and requirements of the regulation, and the other a discussion paper[7] on the potential adverse behavioural incentives stemming from the design, and inherent flaws, of the mandatory buy-in framework. ICMA was currently in the process of finalizing another discussion paper on CSDR buy-ins, this time related to the challenges of applying the regulation to in-scope securities financing transactions.[8]

5) ICMA 's FinTech initiatives

Update

Gabriel Callsen provided the Committee with a briefing on ICMA's various initiatives and workstreams related to 'FinTech' since the previous SMPC meeting.

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[6] See: https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/CSDR-SD-mandatory-buy-ins-information-brochure-190718.pdf

[7] See: https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/How-to-survive-in-a-Mandatory-Buy-in-World---June-2018-290618.pdf

[8] See: https://www.icmagroup.org/assets/documents/Regulatory/Secondary-markets/CSDR-Settlement-Regulation/CSDR-mandatory-buy-ins-and-SFTs-031018.pdf

With respect to primary markets, Gabriel informed members that ICMA had held a roundtable discussion on electronification on May 8. The purpose was to discuss trends and developments from a technology and innovation perspective, and identify the direction of travel in. The roundtable brought together investors, issuers, syndicates, law and technology firms. A common theme of the discussion was creating greater efficiencies, with a focus on process electronification and STP, notably for firms that operate across different markets and currencies. From a technology perspective, minimum common standards for communication, data exchange, and end-to-end connectivity are critical to reduce operational risk and eliminate inefficiencies were discussed. The challenge seems to be how to strike a balance between process standardisation on the one hand, and flexibility on the other, according to funding needs, cash management requirements as well as local market practices.

In terms of secondary markets, Gabriel reminded the Committee that ICMA had reviewed and published a new version of the ICMA ETP mapping directory on June 30, to take into account the evolving market structure. It includes over 40 execution venues, such as Multilateral Trading Facilities (MTFs), Organised Trading Facilities (OTFs), a new regulatory classification of trading venues introduced under MiFID II, as well as information networks and order/execution management systems.

Other initiatives included: a listing of new FinTech applications in primary, secondary, repo and collateral markets, taken from public sources; the publication of a paper on regulatory approaches to FinTech and innovation in capital markets; meetings with a number of regulators, including the FCA, AMF, and BaFin; a cross-cutting meeting on FinTech with chairs and representatives of various ICMA committees; and the roll-out of a FinTech working group as part of the ICMA Futures Leaders (IFL).

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.

The co-chair thanked members for their participation and ongoing support of the SMPC and ICMA's secondary market work. She further thanked Jurian Hoondert for generously taking the time to speak with the SMPC, acknowledging the excellent cooperation with the ECB's CSPP Team over the past two years.

Members will be informed of the date and details on the final SMPC meeting of 2018 in due course

Prepared by: Andy Hill
October 2018