

## ICMA Secondary Market Rules & Recommendations Working Group

### Meeting note from July 3 2018

**Participating firms:** ABN Amro, BCV, BlackRock, Clearstream, Deutsche Bank, Goldman Sachs, JP Morgan, Morgan Stanley, T Rowe Price

#### 1) Special situations

The discussion focused on three scenarios which might occur *after* parties have entered into a transaction:

- (i) Where a bond unexpectedly changes its form into another deliverable security (another bond, equity, certificate of entitlement, 'proceeds', etc.).
- (ii) Where a bond unexpectedly changes its form into something other than a deliverable security – such as a bail-in scenario where it ceases to exist or effectively becomes a 'claim' (or potential claim).
- (iii) Where there is an option to change the form of the bond into another security or proceeds.

These scenarios cover instances where the event occurs either between the trade date (TD) and intended settlement date (ISD), or between the ISD and actual settlement date.

While (iii) falls under the category of corporate actions and is potentially already covered by the ICMA Rules and Recommendations for the Secondary Market ('ICMA Rulebook')<sup>1</sup>, (i) and (ii) are not.

The discussion recognized that each 'special situation' was relatively unique, and that it would be difficult for the ICMA Rulebook to cover every possible scenario. It may be more appropriate for parties to consider the scenario in the context of the law applicable to the transaction and/or negotiate a suitable resolution between themselves.

In the case where a bond no longer exists (i.e. scenario (ii)), it would be particularly difficult to provide specific guidance. In cases where a bond unexpectedly changed its form into another deliverable security (or proceeds), in the absence of firm suggestions as to what the appropriate guidance should be, ICMA agreed to discuss internally whether any proposed wording in the ICMA Rulebook could be

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<sup>1</sup> Rule 183 deals with transactions in securities which are subject to a public offer or solicitation or which have terms providing that certain rights may be exercised up to a fixed deadline.

helpful, or whether the possibility for different situations would make an addition to the Rules difficult to achieve and potentially unhelpful.

### Corporate Actions

Rule 183 of the ICMA Rulebook deals with anticipated corporate actions ('exercise of rights attached to securities or public offers'). However, it does not necessarily cover unexpected corporate actions. It was noted that corporate actions are rarely immediate, and generally have extensive notification, so this would apply mostly in the case of unsettled trades.

It was pointed out that 'Market Standards for Corporate Actions Processing' already existed, having been established by an industry working group led by AFME. ICMA was previously unaware of these standards but will review them. While it is unlikely that the ICMA Rulebook would want to cross-reference these, it may be that it should be consistent with the established standards.

## **2) Buy-in Rules**

It was explained that as a consequence of the CSDR mandatory buy-in provisions, expected to come into force in September 2020, it may be that ICMA will require 3 different sets of Buy-in Rules.

One would be designed to settle trades within the 7-day extension period for fixed income, meaning that the current notification period of 4-10 days may need to be shortened to below 4 days in order to facilitate successful completion of the buy-in before the regulatory 'trigger date'.

The second would aim to be compliant with regulatory framework in terms of timings, as well as providing for the cash compensation remedy in the event that the buy-in is unsuccessful. This may or may not also require the appointment of a buy-in agent, based on guidance provided by ESMA [noting that the RTS currently provide for the appointment of a buy-in agent]. The hope is also that this version of the ICMA Buy-in Rules could find a solution for the current asymmetric treatment of the buy-in/cash compensation differential payments, which is immensely problematic from a market efficiency perspective (creating additional risks for short-sellers and lenders of securities, as well as making the use of 'pass-ons' to settle fails-chains challenging, if not impossible). It was explained that this asymmetry "override" via ICMA Rules may or may not be legally effective and in any case would require discussions with ESMA and the European Commission, and possibly external counsel. The question was raised as to whether the asymmetry in the regulation was intentional, in which case the Commission may be less receptive to a symmetrical buy-in arrangement. It was noted that the asymmetry is almost certainly the result of an error in the Level 1 text [Article 7(6)], but this has never been publicly acknowledged by either ESMA or the Commission.

The third possible set of Buy-in Rules would probably be exactly the same as the current Buy-in Rules, which could be used to remedy failed transactions that are out of scope of CSDR.

The above options are also being discussed by ICMA's CSDR-SD Working Group, and ICMA will continue to update both Groups of its discussions with the authorities.

### Contractual enforcement of ICMA Rules

A question was raised as to whether the ICMA rules were enforceable contractual agreements or were intended to provide guidance.

The objective of ICMA Rulebook is to provide the Association's members with a uniform and reliable framework that reflects current best market practice for trading in debt and related securities (between members and between members and other professional market participants) as well as for the clearing and settlement of such securities.

The rules and recommendations for the secondary market contained in the ICMA Rulebook automatically apply to all transactions between members of the Association involving the sale and purchase of international securities as defined in rule 2.2, but unless otherwise stated do not apply to the syndication and allotment process or to repurchase and to other transactions entered into under the Global Master Repurchase Agreement or similar master agreements. Where a transaction is subject to the rules of an exchange its rules apply. At the time of concluding a transaction, the parties may specifically agree to exclude the rules and recommendations ('opt-out'). An agreement to opt out of the rules and recommendations must be evidenced in writing.

For the purposes of ICMA's rules and recommendations for the secondary market, a rule applies to a transaction and is binding on the parties unless and to the extent permitted the parties specifically agree at the time of concluding the transaction that it shall be excluded. A recommendation, on the other hand, is of a non-binding nature and has moral force only. In other words, the parties to a transaction are encouraged, but not obliged, to follow a recommendation.

### **3) Rule 407**

It was explained that while members were generally keen to keep Rule 407 (which allows for non-faulting purchasers to claim from the seller the loss resulting from the funds payable being subject to a negative interest rate), for many it was irrelevant as they felt that they could successfully manage their cash to avoid such losses. However, some members had raised the issue of some firms refusing to pay claims under Rule 407.

ICMA was contemplating adding a recommendation to Rule 407 suggesting that firms should be prepared to evidence such claims on request. There were no objections or other comments from those on the call.

**Ends**

Prepared by Andy Hill, July 2018