Secondary Market Practices Committee

Meeting of the ICMA SMPC, May 2nd 2017

The meeting was held at ICMA's London offices, and Chaired by Sonali Das Theisen, Citigroup Global Markets

Attendees

In the room:

Sonali Theisen	Citi	(Co-chair)
Dinos Daborn	AxeTrading	
Matthew Coupe	Barclays	
Philip Cramp	BGC Partners	
Domingo Puertastrillo	BNP Paribas	
Dominic Holland	BNY Mellon	
Martina Ben-Shaul	CIBC	
Morten Grove	Danske Bank	
Thomas Hovard	Danske Bank	
David Camara	Goldman Sachs	
Neelam Saini	JP Morgan	
James Taylor	JP Morgan	
Andrew Bowley	Nomura	
Ricardo Goddard	Schroders	
Mathieu Casadevall	SocGen	
Matthew Miller	SocGen	
Elizabeth Callaghan	ICMA	
Gabriel Callsen	ICMA	
Andy Hill	ICMA	(Secretary)
Paul Richards	ICMA	
Mushtaq Kapasi	ICMA	
Bogdan Pop	ICMA	
Peter Eisenhardt	ICSA	

Special guest:

Stephen Hanks	UK FCA

On the line:

Sanne Wijnholts	ABN Amro	
Arran Rowsell	BGC Partners	
Stephen Fisher	BlackRock	
Godfried De Vidts	Nex	(ERCC Chair)
Harald Mueller	ERSTE Group	
Rhys Pullen	ING	
Barbara Zittucro	Intesa San Paolo	
Julien Morris	Jefferies	
Elliot Warren	Pimco	

David Eley	SEB	
Sylvie Bonduelle	SocGen	
Ingemar Bergdhal	Swedbank	
Alex Sedgwick	T. Rowe Price	
Joshua Masters	Westpac	
Vicky Webster	AFME	(Observer)

Chair's welcome

Sonali Das Theisen (Citigroup Global Markets and Co-chair) welcomed those in the room and others dialing-in, in particular thanking the SMPC's special guest for the meeting, Stephen Hanks of the UK's Financial Conduct Authority. Sonali noted that the implementation of 'MiFID' (MiFID II and MiFIR) was perhaps the biggest challenge facing European investment firms in the current time, and there were still a lot of uncertainties around how this would impact market behaviour and dynamics. This meeting of the SMPC was an opportunity to discuss directly with Stephen some of these key issues as they affected fixed income markets in Europe, in particular with respect to credit markets.

The Secretary relayed Yann Couellan's (AXA IM and SMPC Co-chair) apologies for being unable to attend today's meeting.

Agenda items

Section I: MiFID II/R and the European credit markets

1) **Discussion with Stephen Hanks, Manager, Markets Division, FCA[1]**

Post-trade transparency

What are the FCA's views on potentially different deferral regimes across various NCA jurisdictions, (48 hours to 4 weeks), particularly in light of the ICMA members' view that for large or illiquid trades, the maximum possible deferral period should be applied uniformly by all member states?

It was explained that the framework for the deferral regime was established in the Level 1, and this affords member states discretion with respect to the maximum possible deferral period. Accordingly, there is no scope in the Level 2 to alter this. It was further expected that the major jurisdictions, in particular the UK, Germany, and France, would apply the maximum deferral period of 4 weeks.

The question was raised with respect to jurisdictions that have indicated that they will apply the minimum deferral period, of 48 hours, and whether this could fragment liquidity across jurisdictions. It was explained that this was a discussion being had by ESMA, but ultimately it would be down to the

[1] It was made clear to the forum that any views presented in the discussion were the personal perspectives of Mr Hanks, and did not necessarily represent the official stance of the FCA.

individual jurisdictions to make their decision based on their respective considerations. ESMA would prefer a consistent approach, but it had no way of enforcing this.

With respect to timing, it was expected that the deferral periods for the respective national competent authorities (NCAs) would be published by July 3rd, which is the deadline for MiFID II transposition, but it could be that some NCA's publish this later.

There is still uncertainty around the product scope for the transparency regime: for instance, will it apply to non-EU issued instruments such as USTs or JGBs? What is the FCA's view on this issue?

It was explained that the scope applies to instruments that are traded on a trading venue in the EU, which would also apply to instruments issued outside of the EU. This requires trading venues to obtain both the LEI (Legal Entity Identifier) of the issuer and the ISIN (International Securities Identification Number) of the instrument. The FCA was engaged in discussion with the various venues on the challenges of obtaining LEIs for issuers outside of the EU, and recognized that there is usually no direct relationship between issuers and venues. While the FCA was beginning to get a sense of the scale of the challenge, it was difficult to get around this. But it was likely that initially there could be a lot of trading activity without LEIs.

It was pointed out that there is an LEI requirement for transaction reporting, and that this required common standards, not least given the complexity of the IT build to support reporting. It was noted that the issue of LEIs for non-EU issuers as well as non-EU investment firms was constantly raised among ESMA and the various NCAs. While the problem was very much understood, there was no established solution for the moment.

When will the thresholds for liquid and illiquid securities be published?

For bonds, this will be December 2017, while for derivatives this could be as early as July 2017.

What is the FCA's view on the lack of a publicly available, single consolidated tape?

It was explained that there are several elements to this. One is the CTP (Consolidate Tape Provider) regime itself, which is not expected to come into force for bonds until September 2019. However, currently that has not been a single request to be a CTP. If this remains the case, then ESMA has the authority to step in to try to create competition for CTPs, but it is not clear how this would work, particularly if there are no volunteers. Furthermore, as a data provider, one can still sell one's own consolidated data without the burden of being regulated by ESMA as a CTP. So, it could be argued that the incentives are weighted against data providers becoming CTPs.

Secondly, there will need to be a consideration of the APA (Approved Publication Arrangement) regime. To the extent that APAs provide data on a commercial basis, this could be viewed as a proxy for what an authorized CTP might provide. One can then also assess the commercial incentives, in terms of what people are willing to pay for data, and to what extent it excludes access to parts of the market. It will be important to see how what happens in respect of equities, and this will give a clearer indication of how the APA and CTP regimes could evolve for bonds. It should become fairly obvious as early as January 2018 that is there is not a consolidated tape for equities, then this is probably unlikely to happen for non-equities. Furthermore, it will be important to assess the APA regime to ensure that the data is of sufficient quality to be consolidated. So, it is also a case of looking at the whole reporting regime, and not just the CTP regime in isolation.

The ICMA recommendation[2] put forward in its response to the December 2016 ESMA Consultation Paper on its draft regulatory technical standards regarding the creation of a consolidated tape for non-equities was mentioned. The ICMA proposal outlined a centralized ESMA-based solution, which was also self-financing. However, the counter argument for a centralized ESMA owned tape is that they could not be certain that there is a market for the data, and in the event that the economics did not work, it would be the public purse subsidizing the solution, which ESMA is not in a position to risk.

It was suggested that any solution that relied on multiple consolidated tapes was likely to fail, although it was also argued that this may be less of a problem for vanilla products such as cash bonds, but was more an issue for more complex derivatives.

Systematic internaliser regime

It could be problematic that there will be no 'golden source' of systematic Internaliser (SI) entities available to the market for each instrument. Does the FCA feel that this should be addressed by commercial incentives, or that there should be publicly available single data base?

It was explained that this had been debated within ESMA, however, the problem lies in the fact that the regulation does not outline what ESMA is expected to do in this respect, and, again, this comes back to an issue of cost. Many of the NCAs are not willing to pay for this, even if they felt it was within their remit. Meanwhile, the FCA is focused on what it can do from a UK perspective. Ultimately, however, this data does have some intrinsic value, so it could be that vendors are incentivized to collate and provide this information for a charge.

The point was made by an SMPC member that it was a fundamental right to know whether your counterparty is regulated, and so essential to know if they are an SI for a particular instrument or not. Another member added that it was not clear what the different perspectives of the various NCAs were on this, and so it could be the case that not all NCAs will be a source of SI data, increasing the scope for uncertainty and errors.

Broadening the discussion to market data in general, members voiced concern that while a lot of data was being reported and collected, this did not ensure access to it, and it could be that many firms find the costs prohibitive, in particular retail. The question of incentives, either for providing or buying data, was raised, as was the suggestion of a cost-benefit analysis to ensure that the regulation was not creating barriers to entry for some participants and was delivering a level playing field. It was confirmed that the impacts of the regulation will be monitored and reviewed, and where the observation is that it is not delivering the intended outcomes, there is scope to change the framework to ensure that it does. However, it also needed to be borne in mind that this could be complicated further by uncertainty with regard to the UK's future relations with the EU.

[2] See ESMA Consultation Paper on Consolidated Tape – ICMA Submission, December 2016

Reporting

An identified market solution for reporting requirements is the possibility for firms to negotiate a trade OTC, then 'execute' it through an agreed venue (say, within a certain time frame) - similar to the negotiated trade waiver for equities (but without the same limitations. This would be particularly helpful for large/illiquid trades, which are best suited to one-to-one negotiation.

It was confirmed that the regulation is not prescriptive on this issue, and that there was some potential flexibility with respect to trades that were not subject to the pre-trade transparency requirements. It was recognized that larger sizes, or trades in less liquid securities, tended to be negotiated OTC, and that it could be possible for the trade subsequently to be reported through a trading venue, should the venue's rules allow this. Apparently, the idea of a negotiated trade waiver for fixed income had been discussed, but it had been challenging to introduce for equities, and so would be even more complicated for non-equities. However, the 'size specific to the instrument' (SSTI) waiver seemed to be an easier approach, and to the extent that venues have an SSTI waiver, there is the scope to negotiate trades; bringing it back to the rules of the venue.

The question was raised as to when a trade was considered 'done' in terms of the regulation: when both parties agree to the trade, or when it is subsequently put through a platform. It was confirmed that the regulation is clear on this: it is when the parties agree to the trade.

It was suggested that this potential flexibility was helpful for liquidity, but the real value was likely to be in terms of record keeping. This raised the question of when would such a negotiated trade be time-stamped when it was put through the venue. The feeling was that this was likely to be when the trade was accepted by the venue, but this would need further discussion before being confirmed.

The issue of the potential for the contraction of time between pre-trade and post-trade with respect to RFQs in sub-SSTI liquid instruments was another related regulatory concern, and the FCA is currently in discussions with venue on this matter. It could be the case that market participants are receiving pre- and post-trade data at the same time.

Traded on a trading venue

What does this mean? For example, would this apply to a tranche of a CLO traded through an OTF? Can we expect guidance anytime soon?

ESMA were expected to publish guidance on the meaning of 'traded on a trading venue' in the form of 'Q&As' in the very near future, along with other Q&As covering the SI regime and OTFs (organized trading facilities). ESMA had already agreed a position, which would be discussed at the May 23 meeting of the Board of Supervisors, with a view to publication shortly after this. While the Q&A may not answer every single question, it should help provide clarification. It was also confirmed that instruments that did not qualify as 'traded on a trading venue' would be exempt from post-trade transparency requirements.

Best execution

The market is still waiting for clarification from ESMA or the Commission on whether RTS 27 should be applied to securities financing transactions (SFTs), and, if so, how? A number of firms have now started IT builds to comply with RTS 27 for SFTs, although it is clear that the data reported will be neither consistent nor meaningful. Does the FCA have a sense of why the authorities have not yet provided clarity?

It was explained that ESMA had been grappling with this, but it had taken a back-seat as other issues had taken precedence. However, ESMA had drafted guidance, and this should be published following the July 5 meeting of the Board of Supervisors. With respect to whether ESMA was broadly sympathetic with the argument that SFTs should not be in scope of RTS 27 reporting obligations, it was explained that they understood the issues, however, sometimes the approach can be very much in line with the legal nature of the regulation, and other times it could be more pragmatic, but it was not clear which way this would go.

An SMPC member made the point that given the lateness of clarity on this, and other issues, it may not be possible for firms to implement the processes and automation necessary to be compliant in time for January 2018. In these cases, and where firms communicated with regulators, it was asked whether NCAs might be more relaxed with respect to immediate enforcement. It was explained that where firms were experiencing challenges in terms of meeting implementation deadlines it would certainly be a good idea for them to communicate with their NCA. Authorities cannot expect firms to perform the impossible, and in some instances NCAs may need to be tactical rather than strategic with respect to implementation. But communication was key.

The point was raised that MiFID is all about data, which requires technology and infrastructure builds to support compliance. To the degree that there is uncertainty on how aspects of MiFID are to be applied, or where interpretations could change, this made compliance not only challenging but expensive. The example of (CDS) index options was given, as it was still unclear how these should or could be reported, particularly if they fall under scope of the SI regime, given that they are largely non-standardized, OTC instruments. The message, again, was that the authorities would be relatively understanding of these challenges, particularly where firms communicated and rationalized their particular issues.

Costs and charges

How does the FCA view isolating and measuring costs and charges with respect to non-exchange based products, such as bonds, SFTs, and OTC derivatives?

It was confirmed that an ESMA Q&A should be published after the June meeting of the Board of Supervisors that looks at the interaction between MiFID and PRIIPs, and which should have around 5 or 6 points relating to 'costs and charges'. However, this was likely to address issues with respect to application, such as how charges eat into investors' returns, rather than providing exemptions. While the regulation already provided a degree of prescription for the costs and charges regime, the Q&As were unlikely to be overly granular, and the intention was not to outline methodologies for application. One of the main objectives was to ensure that firms could not use the regime to obtain a competitive advantage. But where there are concerns around the application, the FCA would be very happy to discuss these with firms or trades associations.

OTFs

The designation of the OTF category aims to capture the activities of IDBs (inter-dealer brokers). However, it also seems to bring into scope the activity of other firms acting as matched-principal. Where does the regulation draw the line and what constitutes 'ad hoc' business?

Attention was drawn to the recent ESMA Q&A[3] which clarifies the concept of an OTF with respect to firms acting on a riskless-principal basis, as well as the FCA MiFID Consultation Paper, 15/43.[4] It was noted by one SMPC member that the key considerations seem to be whether trading activity is on a multilateral basis and whether the firm has a system in place. The challenge is in what constitutes a 'system'. It was explained that a 'system' would be a business model that was based on generating a significant portion of revenues through riskless-principal trading. One member asked whether this meant that there are firms that are potentially OTFs but they may not realize it. It was confirmed that is possibly the case. The forum was further remined that the deadline for applying for an OTF designation is July 3 2017.

Wrapping-up

The forum was reminded again that ESMA and the NCAs understood that firms faced challenges with achieving full implementation of the regulation by January 2018, and they did not expect them to achieve the impossible. Where firms did have challenges, they were encouraged to discuss these with their regulators, evidencing where the challenges arose and how they intended to be met. However, in terms of prioritization, firms should try to focus on being ready for transaction reporting obligations.

Section II: Market updates

2) Corporate Sector Purchase Programme

Sonali Theisen lead a brief discussion and exchange of views between members on the ongoing impacts of the ECB's Corporate Sector Purchase Programme (CSPP).

Sonali observed that overall the CSPP had only had a small net positive impact on issuance, while bid-ask spreads in the secondary market had tightened. However, since the announcement of the tapering of overall asset purchases there had been a small decline in non-financial investment grade issuance, while eligible bonds had slightly underperformed in secondary, at least in terms of swaps-spreads. Ricardo Goddard (Schroders) added that the fact that the ECB did not appear to be in direct competition in with asset managers had helped, but this could become a problem if the primary market closed.

Andy Hill asked whether the members felt that the ECB should be invited to join a future SMPC meeting, noting that they had attended on two occasions already. It was broadly agreed that this could be helpful, particularly in light of tapering and the end of the programme.

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[3] https://www.esma.europa.eu/sites/default/files/library/mifid_ii_mifir_qa_on_transparency_topics.pdf
[4] https://www.fca.org.uk/publication/consultation/cp15-43.pdf

3) Impacts of changes to the ICMA buy-in rules

Andy Hill asked members to provide feedback on any impacts or issues arising from the recent changes to the ICMA buy-in rules.

None of the members felt that there were any issues arising from the recent changes. Dominic Holland (BNY Mellon) commented that the process had become much easier and far more efficient with the removal of the requirement to appoint a buy-in agent. Lee Goss (ICMA) asked whether there were any issues arising with respect to the buy-in prices being achieved. Dominic responded that so far this had not been an issue, and that the bonds where they had been involved in executing recent buy-ins were not overly illiquid. He further noted that, from his perspective, buy-in premiums were much lower in the current market than historically.

Section III: Market liquidity

4) ICMA Asian Corporate Bond Secondary Market Study

Mushtaq Kapasi, ICMA's Chief Representative for the Asian-Pacific region, provided members with a briefing on ICMA's work in the Asian-Pacific region with respect to corporate bond secondary markets.

Mushtaq informed the forum that ICMA was experiencing more interest from local regulatory bodies on the state of corporate bond secondary markets, and the ICMA reports on the European market had also been well received in the region. However, while there were some parallels, there were also different considerations with respect to regulatory impacts and the starting points for market liquidity. With this in mind, ICMA was looking to extend its research into the Asian markets.

However, Mushtaq noted, there were some high-level challenges. Firstly, even compared to the European market, the Asian market is extremely fragmented, with 12 distinct jurisdictions. Secondly, the domestic markets were very different to the cross-border market, with the latter mainly consisting of G3 currencies. Narrowing the focus of any study would therefore be key, and this was projected to be exclusively on cross-border markets. But in terms of the major themes, the European work provided a helpful and adaptable template, focusing on issues such as the impacts of Basel, the interconnection with repo and CDS markets (noting that there is no real single name CDS market in Asia), as well as electronification and changes in market structure. Like the European studies, the approach was expected to be largely qualitative, based on interviews with key market participants and stakeholders, but there was also the intention to complement this with quantitative data and analysis where this was available.

Mushtaq explained that in some cases he was already in contact with the Asian counterparts of the SMPC members, but not in all, and that he and Andy Hill would like to reach out to the SMPC members to ask for their respective contacts in the region. Furthermore, he would welcome any feedback with respect to the proposed scope and methodology.

Sonali Theisen suggested that looking at the impacts of regulations such as MiFID on the Asian markets could be very useful. However, it would be important to understand what the potential audience for the study cares most about, and to tailor the approach accordingly. Mushtaq responded that there is a great deal of variation in terms of regulation in the region, and that it is not pan-regional such as in Europe. Also, stages of market development and liquidity were very different, for example the authorities in Japan and Australia had very similar concerns to their US and European counterparts. For the emerging markets, such as Malaysia and Thailand, however, the concern of regulators and policy makers was very much focused on investor protection, and scenarios where investors could lose money, and where the ability to liquidate holdings quickly and efficiently was key. This was perhaps an area where ICMA's work could add specific value. He further noted that with respect to MiFID there was not a great deal of sophisticated understanding of the potential impacts for Asian markets. While originally there had been widespread concern, this had gradually dissipated as the general option seemed to be that it would only impact a very small part of the market.

Andrew Bowley (Nomura) noted that there was a lot of development in the trading platform space in Asia, and that many of the larger platform providers were operating separate structures for Asia, as distinct from their US or European platforms: it would be interesting to build up a comprehensive picture of how this was evolving. Sonali Theisen added that related to this it would be interesting to see how Asia was evolving with respect to data and the distribution of information, such as the dissemination of quotes and axes into the market.

Mushtaq wound up by reminding everyone that Andy would be in touch with members soon requesting their relevant Asian counterparts.

5) The state and evolution of the European credit repo market

Andy Hill will provide a brief update on the findings of ICMA's study on the European credit repo market which was now in its final stages, and should be drafted later that month.

Andy noted that the credit repo market was very different to the sovereign repo market, and mainly existed to support market-makers for corporate bonds. The structure of the market was also quite different to government repo, and bank business models varied in terms of the degree to which they focused on servicing their own credit traders or clients, their emphasis on long financing (GC funding) as opposed to specifics ('specials trading'), and their interaction with the street compared with reliance on their franchise. He further noted that the market seems to work relatively well, and while pricing can be volatile, particularly for lower credit names and high yield, it was generally possible to cover most shorts. Where it was becoming more challenging, however, was in the trend toward smaller trade sizes and more rapid dealer inventory turnover: while supply was generally good, the economics did not justify asset managers or agent lenders lending odd-lot amounts for very short periods. Thus, to an extent, it could be argued that the move toward greater platform trading in the underlying market was undermining settlement efficiency.

In terms of future threats to market efficiency, the study suggested that CSDR mandatory buy-ins was the single biggest existential risk, as this created a significant deterrent to lenders. Furthermore, NSFR was expected to put pressure on bank intermediation. Finally, this is a very manual, labour-intensive market, where the application of technology and innovation has so far been relatively inchoate.

Section IV: Other SMPC and Working Group initiatives

6) Regulatory initiatives

The SMPC secretariat provided short updates on SMPC initiatives specifically related regulation.

MiFID II/R

Liz Callaghan (ICMA) informed the SMPC that ICMA, in consultation with members of its MiFID II/R Working Group, had published a position paper with respect to the post-trade deferral regime.[5] Liz explained that MiFIR afforded NCAs with discretion in the case of applying post-trade reporting deferrals where the trade is large in scale (LIS) or the underlying security is classified as illiquid. This includes the publication of supplementary details as well as the possibility of extending the timing of the deferral from two-days up to four-weeks. However, there is a risk that the various NCAs will apply different deferral periods (as discussed earlier with the FCA), which could fragment liquidity across the EU. For example, some jurisdictions, such as Sweden, have suggested that they may apply hybrid domestic transparency models, which would disadvantage firms required to report to these authorities. ICMA's position was that ESMA should require all NCAs to apply the maximum 4-week deferral period for LIS and illiquid trades. Liz confirmed that this position was consistent with that of AFME and the SSDA.

CSDR-Settlement Discipline

Andy Hill informed the SMPC that ICMA, in consultation with a range of committees and members, had published a position paper with respect to CSDR Settlement Discipline.[6] ICMA proposes that the suggested cash penalty rates in the Level 2 should be increased for bonds, when implemented in 2019. Meanwhile, the projected mandatory buy-in regime should not be implemented. Instead, the impact of cash penalties and other measures to improve to settlement efficiency should be monitored, and the buy-0in regime should only be implemented as a last resort. Andy reminded the Group that ICMA has actively advocated against a mandatory buy-in regime since its inception, pointing to its inherent flaws and the likely adverse impacts on market stability and liquidity.

7) Any other business

There were no other points of business.

Closing remarks from the Co-chair

Sonali Theisen thanked all those in the room and on the call for an active and engaged discussion, and for providing informed input, which would also have been appreciated by Stephen Hanks, who had been an excellent guest. Sonali noted that the secretariat would soon be in touch to announce the date of the next meeting.

[5] See: MiFID II/R Post-trade transparency: trade reporting deferral regimes. An ICMA Position Paper

[6] See: ICMA Position Paper on CSDR Settlement Discipline

Prepared by: Andy Hill & Gabriel Callsen, May 2017

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