

ICMA Regulatory Policy Newsletter

Quarterly Assessment – Issue No. 10: July 2008

Editor: Paul Richards

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ICMA welcomes feedback and comments on the issues raised in the Regulatory Policy Newsletter.

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The ICMA Asset Management and Investors Council

Foreword by Bob Parker, Vice Chairman, Credit Suisse Asset Management and Chairman of the ICMA Asset Management and Investors Council

I have been in the asset management industry for 35 years now and, looking back over the past 30 years or so, the asset management industry in the 1970s and early 1980s was quite simple. The client base was mainly defined benefit pension funds and life insurance companies. Investors had a very strong home bias – French investors invested in France and English investors invested in UK equities or bonds. The typical mandate was very much balanced, with asset allocation being set by the asset managers. Where capital in the hedge fund industry is now in excess of \$2 trillion, in the 1970s the total capital in the hedge fund industry was only a few billion dollars. Although sovereign wealth funds have been around for a very long time, the sovereign wealth fund industry – if I can use the word “industry” here – was very small. For example, I will always remember my first trip to Beijing in the early 1980s. The reserve fund of the Chinese, which then used to be called “the State Administration of Exchange Control” had \$10 billion under management. If you add up what is now called “the State Administration of Foreign Exchange” and China Investment Corporation, the reserve fund has effectively grown, over the past 25 years, from \$10 billion to about \$1.7 trillion. The amounts of money going into sovereign wealth funds are therefore extraordinary. Another feature of the industry has been the development in the private banking market and the family offices market. We have therefore seen this very radical change in the asset

management industry. Not only the client base has changed, but the types of asset management products have also changed radically.

The purpose of the ICMA Asset Management and Investors Council (AMIC) is primarily to represent the views of the buy-side members of ICMA. ICMA is one of the few trade associations with a European focus having both buy-side and sell-side representation. As I explained at the ICMA 40th AGM back in May, the increasing work between the buy-side and the sell-side during the last 10 months shows that the buy side and the sell side might have done a better job if they had cooperated better. ICMA provides a platform that will be conducive to an improved dialogue between the



*Bob Parker
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The ICMA Asset Management and Investors Council - continued



Panel on The Changing Role of Investors at the ICMA Conference in Vienna on 15 May.

buy side and sell side, when both consider this appropriate. Robert Gray, the Chairman of ICMA Regulatory Policy Committee, presented the view of the sell side to the Asset Management and Investors Council at its last meeting in June. This inter-relationship between the sell-side Committees and the AMIC will be encouraged going forward.

Moreover, taking into account the changes that have occurred in the industry, the AMIC composition embraces the diversification and the current dynamics of the industry – taking the asset management representation to a broader and global level. Originally the Council was simply to be named the Asset Management Council. Yet, as final investors (including insurers)

are represented, as well as all types of asset managers, the name changed to the AMIC. The name reflects the widest representation of the asset management industry.

At our first AMIC meeting, the Council agreed upon its objectives. The focus is to be on asset management in Europe, while recognising that asset management is a global business. The AMIC will act as a think tank, identifying key trends in the industry and presenting position papers to the market. The AMIC may also propose market-led initiatives and market practice guidelines, where these are appropriate, and responding to consultation papers from regulators. Finally the AMIC should play a key role in the educational space,

assisting bodies such as the Chartered Financial Analyst (CFA) Institute.

So, in practical terms, what's next for the AMIC? Our next meeting is scheduled for September and we will be tackling issues such as managing clients' expectations, money market funds, and indexation and benchmarking, as well as monitoring regulatory trends in the asset management industry. The agenda reflects the objectives of the Council – a mix of key regulatory trends, projects for market-led initiatives and educational elements.

Bob Parker
Vice Chairman,
Credit Suisse Asset Management

ICMA's role as a self-regulatory organisation

René Karsenti
Executive President, ICMA*



I think that the recent market turbulence has shown that ICMA's role in the capital markets is as important now as when it began 40 years ago. We have a self-regulatory role in helping to make the market function. And we are in a good position to help restore and maintain orderly markets, because we bring together practitioners, issuers, dealers and investors – both the sell side and the buy side – under one roof.

It is therefore timely that the ICMA Board has decided that we should bring our Rules and Recommendations in the secondary market up to date to ensure that they are as useful as possible to our members. A Working Group of members under the chairmanship of Michael Ridley of JPMorgan has been set up to make recommendations. Such rules have been in existence for many years and have formed the basis of the orderly development and functioning of international securities trading between members and other market participants and clearing and settlement of trades.

And we have taken a series of other practical steps to help restore and maintain

orderly markets. We are undertaking an intensified dialogue with regulators and central banks. We are promoting the use of the robust market framework provided by the Global Master Repurchase Agreement, and the market practice guidelines developed by the European Repo Committee chaired by Godfried De Vidts. We are participating in the Institute of International Finance's Working Group on valuation and liquidity. We are also participating in a joint industry initiative to provide greater transparency in the securitisation markets. And we have consulted the market and have now finalised a Voluntary Code of Conduct on Disclosure in the Asset-Backed Commercial Paper Market. The Code has been drawn up by ICMA's ECP Committee, under the chairmanship of Peter Eisenhardt of Bank of America.

The search for ways of restoring market confidence has been at the heart of the work of our Regulatory Policy Department over the past year. Our work on regulatory policy and good market practice is one of the main functions of ICMA as a self-regulatory organisation and international trade association, and one of the main potential benefits for our members. ICMA's role involves taking practical steps to restore market confidence by seeking a consensus among our members on setting standards of good market practice to make sure that the market functions well.

In summary, the latest turbulence in the capital markets has reminded us that ICMA and its members have a responsibility to continue their activities in support of an efficient functioning of truly integrated global financial markets and to ensure that an efficient and robust regulatory infrastructure, which respects free market principles, is in place to support them.

** Based on the author's speech to the ICMA AGM in Vienna on 15 May.*

IIF Final Report

Briefly summarised, the Institute of International Finance's *Final Report of the Committee on Market Best Practices: Principles of Conduct and Best Practice Recommendations*, to be published in July, and amplifying the *Interim Report* published in April, will make recommendations along the following lines:

Risk management: Firms should develop a robust risk culture that is embedded in the way they operate, covering all areas and activities. This should result in risk management being a priority for the whole institution. Firms should take a comprehensive approach to risk, integrating strands such as credit, market, operational, liquidity and reputational risk.

Compensation policies: Compensation incentives should be based on performance, and aligned with shareholder interests and long-term, firm-wide profitability.

Liquidity risk, conduit and securitisation issues: The recommendations on liquidity risk from the IIF's *Principles of Liquidity Risk Management* (2007) have been validated by recent experience, and firms should ensure their appropriate implementation as updated in the IIF's *Final Report*:

- Recent events show the importance of effective internal liquidity-transfer pricing, by which firms can create incentives for business lines to act in full cognisance of the liquidity risks their businesses incur.
- Firms need to emphasise stress testing to enhance liquidity risk management under changing market conditions.
- Firms that rely on market funding should evaluate asset liquidity and

potential reputation risks under stressed market conditions.

- Good liquidity risk management requires the inclusion of formal contingent obligations to off-balance vehicles, and a clear appraisal of the potential impact of supporting such vehicles.

Valuation issues: Fair value accounting is an essential element of global capital markets, fostering transparency, discipline and accountability. The *Final Report* recommends that there should be a high level dialogue on the application of fair value accounting in illiquid or difficult market conditions.

Credit underwriting, ratings and investor due diligence in securitisation markets: Firms involved at all stages of the originate-to-distribute process should conduct adequate due diligence and apply appropriate lending standards (including internal credit approval) regardless of whether assets are to be held on the books or distributed.

Transparency and disclosure issues: At structured product level, prospectuses should have a summary of key characteristics, and a list of critical risk factors. Global harmonisation of market definitions and structures would greatly assist the future development of the structured product market.

At financial institution level, firms should ensure that their disclosures provide a sufficient overview of their current risk profiles and risk management processes, including their securitisation activities.

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Industry initiatives on transparency

On 2 July, nine European and global trade associations released *Ten Industry Initiatives to Increase Transparency in the European Securitisation Markets* in response to the call of the European Council of Finance Ministers (ECOFIN), in its October 2007 Roadmap, to “enhance transparency for investors, markets and regulators” by

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mid-2008. These initiatives represent the results that the associations committed to deliver to the European Commission in a joint letter on 8 February.

The ten initiatives comprise:

- draft Industry Good Practice Guidelines on Securitisation Disclosures under Pillar 3 of the Capital Requirements Directive;
- the creation of a new industry Quarterly Securitisation Data Report, which

provides comprehensive, frequent and relevant statistical data on EU and US securitisation markets; and

- eight additional issuer and investor focused initiatives.

The first of these to be completed is the Code of Conduct on Disclosure in the ABCP Market. This was developed by ICMA's ECP Committee, and has also been endorsed by the European Securitisation Forum:

Code of Conduct on Disclosure in the ABCP Market

Introduction

Purpose of the Code of Conduct: The asset-backed commercial paper (ABCP) market in Europe proposes to adopt a Code of Conduct on disclosure as a standard of best practice. The Code of Conduct is designed to ensure that investors in ABCP have timely access to information through different sources: the information memorandum; the monthly investor report; investor meetings; and rating agency reports.

The information should be reviewed by investors, both before buying and on an ongoing basis. Purchases should not be based on rating alone. Specifically, investors should know, monitor and be comfortable with: the type of assets financed; the sponsor of the programme; the sponsor's ability to administer the programme; the liquidity support and credit enhancement provided; and the mechanism for repaying the commercial paper should market conditions not permit rollover.

Status of the Code of Conduct: In keeping with the European Commission's preference for market-led initiatives as opposed to additional regulation, the Code of Conduct will be voluntary. Participants in the ABCP market will be invited to comply with the code.

The International Capital Market Association, through its Euro Commercial Paper Committee, and the European Securitisation Forum have agreed to promote the Code.

Dialogue between issuers, investors and

dealers: ABCP market participants are keen to cooperate to enhance the information provided should that be required. However it is important to note that the vast majority of those directly involved in the market, and particularly those in the investor community, do not believe that a lack of transparency – through failure to provide adequate disclosure – has been a significant contributor to the recent global market turbulence.

ICMA, through its ECP Committee, will facilitate dialogue between issuers, investors and dealers in the ABCP market with the objective of finding a market-led solution to recent concerns. When the market has settled, the Code will be reviewed with issuers and investors to ensure that it meets investor needs in the new market environment.

Code of Conduct

Programmes wishing to issue asset-backed short term debt should provide the following information on a timely basis and ensure, where appropriate, that it is kept up-to-date:

- *Information memoranda:* The information memorandum is the primary marketing document of the programme, which should include issuer description, terms and conditions, form of notes, and selling restrictions. Currently this is usually only made available to actual and potential investors permitted under the selling restrictions, as the commercial paper is sold to institutional investors in the private placement market and usually is not listed on an

exchange. The information memorandum should be subject to appropriate legal review.

- *Investor reports:* The investor report is a regular update on the vehicle provided by the issuer to investors. Issuers should distribute investor reports on a monthly basis at least. They should describe current assets and verify compliance with key programme tests or requirements. In general, issuers should include the following information: total asset size; total commercial paper outstanding; asset type breakdown; credit enhancement and overall liquidity support. Investor reports should normally only be made available to programme investors, so as to limit the transmission of sensitive client and competitive information and comply with private placement rules.
- *Investor meetings:* Issuers should make themselves available for *ad hoc* conference calls or meetings to address queries from active investors as they arise. Investors should have access to senior conduit management and senior bank management to assess the commitment of the sponsor.
- *Rating agency reports:* Programmes should have ratings from at least two recognised rating agencies. In order to obtain these, issuers will need to meet structural and credit standards, satisfy documentation requirements, and be subject to ongoing monitoring and surveillance.

June 2008

EU audit regime

Following the 29 June implementation deadline for the Statutory Audit Directive, there are several issues about which to report:

Progress towards accounting equivalence: The European Commission has published proposals for two instruments concerning the equivalence of third country accounting principles with EU-adopted IFRS.

- A proposed [Regulation](#) would amend (from 1 January 2009) the Prospectus Directive to confirm the equivalence of US GAAP, Japanese GAAP and (subject to inclusion of explicit confirmation in the notes to the relevant accounts) IFRS and to provide certain exemptions from certain specific requirements of the directive to Canadian, South Korean and Chinese GAAPs.
- A proposed [Decision](#) would confirm, in relation to the Transparency Directive, the equivalence of US GAAP, Japanese GAAP and (subject to inclusion of explicit confirmation in the notes to the relevant accounts) IFRS and, for a transitional period (financial years starting prior to 1 January 2012), Canadian, South Korean and Chinese GAAPs.
- The [January edition](#) (on page 9) of this Newsletter envisaged publication of final instruments in mid 2008. However, a formal vote by the European Securities Committee is now envisaged for the autumn, with formal adoption and publication of the two instruments to follow before the end of the year.

Auditors of non-European issuers: As envisaged in the [April edition](#) (on page 7) of this Newsletter, the Commission has published a further draft of its [Decision](#) on equivalence for third country auditors. The draft contemplates equivalence for 35 jurisdictions¹ for audits relating to financial years starting until 1 July 2010. The

final Decision is expected to be formally adopted around the publication time of this Newsletter. In a related development, the UK's Professional Oversight Board has published a [Consultation Paper](#) on its proposed implementation of the relevant registration provisions in the UK.

Auditors' liability: In 2007, ICMA responded to the Commission's consultation on the possible limitation of auditors' liability for statutory audits (see page 7 of the [April 2007 edition](#) of this Newsletter). The Commission has now published its [Recommendation](#) on auditor liability. It recommends EU Member States to limit liability for statutory audits of listed companies by a fixed cap, proportionate liability or agreement, though injured parties should not be prevented from being "fairly compensated". The related Frequently Asked Questions ([FAQs](#)) note, however, that fair compensation may be limited by consequential legislation and state that Member States should consult stakeholders on the impact of any proposals on financial markets and investors.

In a related development, the UK's Financial Reporting Council has issued [guidance](#) on auditor liability limitation agreements under the Companies Act 2006. The guidance: (i) explains what is and is not allowed under the 2006 Act; (ii) sets out some of the factors that will be relevant when assessing the case for an agreement; (iii) explains what matters should be covered in an agreement, and provides specimen clauses for inclusion in agreements; and (iv) explains the process to be followed for obtaining shareholder approval, and provides specimen wording for inclusion in resolutions and the notice of the general meeting.

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State guarantees

On 20 May, the European Commission adopted a new [Notice](#) on state aid in the form of guarantees. The Notice sets out a method of calculating the aid element in a guarantee and provides simplified rules for small and medium sized enterprises, including predefined safe-harbour premiums and single premium rates for guarantees of low amounts.

The outcome of this new legislation is significant for those issuers who benefit from state aid. The main purpose of the Notice is to determine whether a guarantee constitutes state aid or not according to Articles 87 and 88 of the EC Treaty. However, the Notice does not address whether any particular kind of aid is permitted. The provisions of the Notice apply to all guarantees where a transfer of risk takes place. This means that the new regulation applies to bond issues if there is a guarantee in place.

The main change compared with the old regime is a market investor test: if new funding is made available on conditions which would be acceptable for a private market player under normal market conditions, such a financial arrangement will not then fall within the definition of state aid.

In terms of individual guarantees, the Notice exempts financial arrangements from EU regulation of state aid if all of the following conditions apply:

- the borrower is not in financial difficulty;
- the guarantee is linked to a specific financial transaction, for a fixed maximum amount and a limited time;
- in relation to debt securities, the guarantee does not cover more than 80% of the outstanding financial obligation; and
- the price paid for the guarantee is at least as high as the corresponding benchmark from the market.

Member States are to meet the stipulations of the Notice by 1 January 2010.

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¹The 35 jurisdictions are: Argentina, Australia, Bahamas, Bermuda, Brazil, Canada, the Cayman Islands, Chile, China, Croatia, Guernsey, Jersey, the Isle of Man, Hong Kong, India, Indonesia, Israel, Japan, Kazakhstan, Mauritius, Mexico, Morocco, New Zealand, Pakistan, Russia, Singapore, South Africa, South Korea, Switzerland, Taiwan, Thailand, Turkey, Ukraine, the United Arab Emirates and the United States of America. Malaysia might be included in the final Decision.

Prospectus Directive review

As reported in our [April Newsletter](#) (page 8), the European Commission is initiating its formal review of the Prospectus Directive. A Consultation Paper, to which ICMA will respond, is expected to be published shortly.

As reported in our [January Newsletter](#) (page 8), ICMA wrote a letter to CESR expressing concern about the possible impact of some of the answers in CESR's September update of its FAQs regarding prospectuses. CESR has helpfully addressed most of ICMA's concerns in the [5th Updated Version](#) of its FAQs, which was published in May.

The updated FAQs *inter alia* cover:

- interpretation of item 20.1 of the Prospectus Regulation's Annex 1 – where the FAQs clarify what is meant by “such shorter period that the issuer has been in operation”;
- right of withdrawal – where the FAQs now clarify that base prospectuses may sometimes be supplemented even when there is no offer pending and therefore no acceptances to be withdrawn;
- information on taxes on the income from the securities withheld at source – where the FAQs now clarify that disclosure of information on withholding tax “at source” refers to withholding within the control of the issuer and its agents (and not investor custodians).

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Market Abuse Directive Level 3: CESR guidance

Following CESR-Pol's [Work Programme](#) concerning Level 3 of the Market Abuse Directive, CESR has confirmed that CESR-Pol will undertake another stream of Level 3 work on market abuse.

CESR-Pol has now published the first of two [Consultation Papers](#). This focuses on harmonisation of requirements for insiders' lists and suspicious transactions reporting (STRs). A second Consultation Paper on stabilization and inside information will be published later this year.

In terms of insiders' lists and STRs, CESR is inviting market participants to indicate whether they think that there are any further issues which CESR should consider, and if so why. We propose to submit a response together with the British Bankers' Association by 30 September, when the first consultation closes.

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Retail investment products

In the April edition of this Newsletter, we reported on the Joint Associations' Committee [submission](#) to the European Commission's Call for Evidence on the need for a coherent approach to product transparency and distribution requirements for “substitute” retail investment products. The Commission is particularly interested to hear whether the current fragmented regulatory framework provides a sound basis for ensuring that

investors receive the information and the quality of service they need to make appropriate investment decisions.

Following the Call for Evidence, the Commission hosted in May an industry workshop on retail investment products to discuss the responses to the Call for Evidence; and is organising an [open hearing](#) in Brussels on 15 July.

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Principles for managing the distributor-individual investor relationship

The Joint Associations' Committee has published a second set of non-binding [principles](#) relating to retail structured products. The principles seek to address several issues which are important in the distributor-individual investor relationship, including fair treatment for the individual investor. Individual investors need to take responsibility for their investment goals and to remain informed about the risks and rewards of their investments. Distributors of the retail structured products can play a major role in helping investors achieve these objectives.

In 2007 the Joint Associations' Committee published an [earlier set of principles](#), focusing on the management of the relationship between providers and distributors from the perspective of firms performing either function.

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Bond market transparency

Michael Ridley

Global Head of Syndicate, JPMorgan*



I was never convinced by the academic studies saying that TRACE provided an improved liquidity position for the market. Along with many of my colleagues in research and at the trading desks, I have always believed that the measurement of liquidity in terms of bid-offer spreads tightening was totally artificial because that same phenomenon occurred at the same time in the European marketplace, where TRACE did not exist. We believe strongly that this resulted almost entirely from the rapid dissemination of pre-trade transparency, such as prices on the Internet, Bloomberg, Reuters and other transmission mechanisms, that were provided as a service to investors by the banking community. Therefore, we are not convinced that TRACE has had any positive impact on liquidity.

In terms of negative impacts, the evidence is purely anecdotal but pervasive. On my own trading desk in New York, it is very clear that the willingness of individual traders to provide firm bids on TRACE-eligible bonds has declined further over the past 10 months. When markets are fundamentally illiquid, the last thing a trader wants is to purchase an off-the-run security and to have the rest of the market made aware of a large position in dealers' hands. The ramifications on the dealer's ability to sell this position and the price obtained have led to more defensive pricing and often an inability for investors to find firm dealing prices. Instead, we found

that our trading desk remains willing to put prices on 144A securities in the US market but is less willing to put prices on off-the-run SEC-registered securities, where the price would flow immediately through the TRACE system.

Academics would probably dispute my comments on 144A versus SEC trading because the volumes are still going through in both markets. However, in response, I would say that when a client wants to sell a large block of an off-the-run SEC-registered security, he might receive an indicative price, take an order and, over the following hours, days or weeks, we will try to liquidate that position for the client. Eventually, that trade will flow through the market and through TRACE. When it flows through TRACE, we do not know if the order was given 10 seconds in advance of the trade or several weeks in advance.

In Europe, there is a different market dynamic. The lack of forced disclosure leads to better liquidity being available in the European market. The quote-driven system relies on capital committed to the market by the member firms represented here to ensure that we offer a degree of liquidity to our investing clients, by committing this capital and by taking risk.

According to the ICMA database, there are 160,000 individual bonds listed. Of those, only 13,000 have had a recorded trade or even a recorded price quotation transmitted through the Council of Reporting Dealers to ICMA over the past six months. That leaves 147,000 bonds, in other words the vast majority of the outstanding securities in our marketplace, that have not traded or have not even been quoted publicly over the past six months.

My concern is that we need to focus on liquidity. The markets have been regaining some confidence since March and a degree of liquidity has returned to the secondary market. If we go to a TRACE-type system

and provide a disincentive to market participants to commit capital, that already heavy imbalance between the 13,000 bonds traded and the 147,000 bonds that do not trade will be exacerbated. In particular, if asked, dealers probably would put a price on many of the 147,000 bonds. The price may not be to the liking of the investor but would at least offer a degree of liquidity to the investor. If that price were to be transmitted publicly, this willingness would disappear and those 147,000 bonds would probably stay firmly in the illiquid category. I am also concerned that the 13,000 bonds that are actively traded or quoted might dry up. In current market conditions, it is essential to look at the trade-off between transparency and liquidity provided by the marketplace through capital commitment and ensure that the provision of post trade transparency does not damage liquidity even further.

The Financial Stability Forum report says that post-trade information about prices and volumes in the secondary market is critical to the re-enforcement of valuation practices for credit instruments and as supplementary information on the scale of risk transfer. I slightly disagree with that: I think it is important but not critical. Only around 8% of the universe of bonds concerned can have any semblance of liquidity. For the average holder of one of the other 147,000 bond issues, the price at which he might be able to liquidate a bond is far more critical than the price at which it might have traded in the distant past. Therefore, I think that pre-trade transparency, which is actively being provided by market participants, is probably more relevant from a price formation point of view. It is important to distinguish between the last marginal price that has traded in the market and the forward-looking average price the investor will achieve for the size of the position they are looking to sell.

The capital-driven system under which we operate is providing a framework for pricing,

albeit academic at present, because we all know that we can ask for the price of a reasonably liquid bond and that price works, but often only in small sizes. In the current market, for a large block of securities, the difference between the quoted price and price that works in your size may be very significant. Therefore, pre-trade transparency has contributed dramatically to investors' ability to value their positions and most of the investment community, on both the institutional and retail intermediary side, have access to multiple price sources. Those prices may not work for the size in which they wish to trade but at least it is a better indication of current value than historic trading prices that may belong to a different time and to different market conditions.

There are also other valuation tools of use. We all hedge our interest rate risk through the derivatives markets and we can hedge far more readily now than we could three years ago. One can also hedge actively in the index markets and there are other relative value tools that probably provide a better guide to current market price and valuation than a post trade piece of information. However, in the past few years, I have come to believe that information on market volumes (disseminated with a reasonable delay) for individual bonds can be quite valuable. It is important to know whether bonds trade in any size over a period of time and this does not have to be real-time information. The volume information being provided through the ICMA retail system, which is effectively a month delay, is probably adequate as it allows investors to look at bond issues over time and to see which names or maturities trade. This makes the potential illiquidity risks more visible when they purchase a particular type of security.

**Based on the author's opening remarks during the Market Transparency Panel at the ICMA Conference in Vienna on 15 May.*

ICMA's bond market transparency initiative: preliminary review

Ahead of the European Commission's Article 65 review under MiFID, we consulted our membership and developed – in a working group of members – our Standard of Good Practice on Bond Market Transparency for Retail Investors. The [Standard](#) was published in September 2007. Since December, Xtrakter has provided a service (www.bondmarketprices.com) which meets the Standard.

In its [Review](#) under Article 65 of MiFID, which was published on 3 April 2008, the Commission was supportive of ICMA's market-led initiative, as well as SIFMA's proposed educational initiative. But the Commission also concluded:

“Such self-regulatory solutions should however give retail customers access to meaningful prices. The ICMA system, for example, calls for trades between €15k and €1m to be captured for the purpose of generating end of day prices. Where no trade is done on a particular day then no prices are displayed. Clearly, if for a particular bond it frequently happens that the only trades done on a day are over €1m or under €15k, the danger is that the system will frequently not give access to prices at all. For this reason, the Commission services would encourage all designers and implementers of self regulatory solutions, including ICMA and SIFMA, to consider carefully the design parameters so that retail access to realistic and up-to-date prices is broadened and deepened to the fullest extent possible consistent with ensuring that liquidity is not impaired. The Commission services will therefore continue to monitor closely whether the currently envisaged self-regulatory initiatives develop satisfactorily, attract adequate adherence and geographic coverage, and are utilised by investors so as to achieve the intended results.”

As proposed in the Standard, we intend

that ICMA's Regulatory Policy Committee should carry out a review after the first full year's operation. However, ICMA's Regulatory Policy Committee has already made a preliminary review to establish whether improvements can be made at this early stage, both as regards the technical specifications of the Standard and www.bondmarketprices.com, and also the accessibility of www.bondmarketprices.com to retail investors, given that usage so far has been low.

On the technical specifications, the Committee's preliminary conclusions were:

- Increasing the upper ceiling from €1m to €2m would increase the number of trades covered only from 70% to 75% of all reported trades in euro, based on a sample of bonds; and the risk to liquidity would outweigh any potential benefit in increased trade coverage, particularly in current market conditions.
- While a reduction in the €15k trade size floor would yield a somewhat more significant increase in the number of published trades, this would be achieved at the expense of a considerable increase in the daily price range of reported trades, given the impact of fixed commissions and transaction costs on small trades. That would reduce the utility of the service to retail investors, who are looking to see the price range before the addition of commission and charges.
- It is also important to remember that, while the most liquid sector of the market is covered, the reason why no prices are displayed on a particular day is that many bonds do not trade on a daily basis.

A number of changes are being considered to improve the accessibility of www.bondmarketprices.com to retail investors:

- The translation of the user guide into some other European languages would increase the appeal of the service across Europe.
- The inclusion of information about the minimum denomination of bonds might

be useful to retail investors. A retail investor with €10,000 to invest is unable to buy a bond with a minimum denomination of €50,000.

- Technical improvements might make it easier for retail investors to search for www.bondmarketprices.com on the web.
- It is intended that electronic links should be established between www.bondmarketprices.com and the educational service being developed by SIFMA, along the lines of its successful service in the US, which is expected to be launched shortly. The price service provided by Xtrakter and the educational service provided by SIFMA are designed to complement each other.
- Steps are also being taken to draw the Bond Market Transparency Standard and www.bondmarketprices.com to the attention of national regulators, trade associations and retail organisations across Europe. ICMA is interested in hearing from any of these if they would like more information about the Standard and Service.

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Transaction reporting

Transaction reporting has continued to be on the industry's agenda since implementation of the new reporting requirements imposed by MiFID.

The FSA has begun consultations with the industry regarding the implementation of the Alternative Instrument Identifier (All). Chapter 23 of the FSA [PS07/18](#) confirmed that the implementation of All would be deferred. The deferral was in recognition by CESR and the FSA that the industry had been given insufficient time to establish appropriate reporting requirements utilising the alternative identification code. CESR is expected to confirm that competent authorities will not be required to receive transaction reports in respect of non-securities (commodity, foreign exchange

and interest rate) derivatives admitted to trading on regulated markets.

It is understood that CESR's target date for implementation of All reporting requirements is November 2008. The FSA is now in the process of discussing with the Approved Reporting Mechanisms (ARMs) and the industry the requirements relating to implementation of All. Implementation is considered unlikely prior to the first quarter of 2009. The FSA has advised the industry that it will incur significant costs as a result of the need to amend SABRE II to facilitate All transaction reporting. Originally, the FSA estimated these costs at between £5-10 million: a more accurate figure should be available towards the end of 2008. The FSA has outlined its approach in [PS08/5](#).

Since MiFID implementation, the industry's ability to report effectively has been hampered by concerns about reference data accuracy and reporting in legacy currencies. In the first case, the FSA is attempting to address [synchronisation of the data](#) to enable correct validation and processing of transactions and to ensure a common approach. In the second case, CESR and the FSA have now added the relevant currency codes to enable the reporting of securities in legacy currency. It is understood that back reporting of activity since MiFID implementation, previously rejected, will not be required.

After MiFID implementation, the FSA initially indicated that the transaction reporting requirements would be subject to a degree of regulatory forbearance. It is understood the FSA now expects firms to comply with the requirements and encourages firms to check the integrity of the information they submit. Firms can request [sample transactions](#) via the FSA website to ensure that their reporting is accurate.

The FSA has recently provided an update and guidance on transaction reporting in its latest *Market Watch Newsletter No.28*.

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Regulatory trends in asset management

Martyn Hopper and Patrick Buckingham,
Herbert Smith LLP*

Disclosure of short positions

The UK FSA proposals for a disclosure regime for short positions in issuers undertaking rights issues entered into force on 20 June:

- The amendments to the Code of Market Conduct require disclosure of “significant” short positions in securities admitted to trading on prescribed markets where the issuer in question is subject to a rights issue.
- The new rule requires disclosure of an aggregate net short position which represents an economic interest of 0.25% or more of the issued share capital of the company. Calculation of an economic interest includes derivative positions.
- The disclosure regime applies to all market participants (whether regulated by the FSA or not) dealing in securities relating to the issuer.
- Disclosure has to be made no later than 3.30 pm on the business day following the date on which the disclosable short position is reached.
- The FSA has published frequently asked questions (FAQ) to clarify practical issues raised by the industry.
- The new rules are apparently temporary and there will be further consultation to find a lasting solution.

The FSA has acknowledged that short selling is not of itself abusive. If so, it is not clear why undisclosed short positions at or above the 0.25% threshold are now capable of constituting market abuse where a rights issue is taking place, though some industry participants feel that the underlying policy objectives (of facilitating the recapitalisation of financial institutions) justify the means. It is also not yet clear whether regulatory attention will focus on short positions in other contexts, including at European level.

Disclosure of contracts for difference (CFDs)

The current regime in the UK works as follows:

- An estimated 30% of equity trades in the UK are driven in some way by CFD transactions.
- CFDs remain outside the regulatory framework governing disclosure: the existing disclosure regime (which is based on the Transparency Directive) is driven by changes in voting rights and does not catch pure cash-settled derivatives.
- The existing disclosure regime applies to all market participants (whether regulated by the FSA or not) dealing in UK listed equities.
- A company’s power of investigation to identify those interested in its securities currently has no application to cash-settled derivatives.
- The disclosure regime under the UK Takeover Code applies to dealings in an offeree company during an offer period and catches dealing in long derivative positions.

The disclosure of CFDs is subject to the current FSA consultation (CP07/20, November 2007). The FSA put three options forward for consultation:

- *Option 1:* no change.
- *Option 2:* strengthening the existing regime (this is the FSA’s clear preference): There would be no requirement to disclose if specified “safe harbour” criteria are satisfied. CFDs falling outside the safe harbour would be aggregated with other shares/instruments with voting rights and disclosed at relevant thresholds. There would be a new power for a company to request disclosure of safe harboured CFDs above the 5% threshold (ie a “flush out” mechanism).
- *Option 3:* general disclosure regime: This would involve disclosure of all economic interests above 5% held through CFDs without aggregating them with shares/other instruments with voting rights. The

disclosure regime for shares/other instruments with voting rights would continue in its current form.

The FSA is expected to publish a policy statement in the third quarter of 2008. There may also be further work by CESR on the disclosure of derivative positions as part of the Transparency Directive Level 3 work programme. It is possible that the FSA is trying to influence the European debate by adopting pre-emptive UK rules.

UCITS IV

UCITS IV was expected to address a number of shortcomings with the current UCITS framework. The key original goal of UCITS IV was to introduce a full management company passport, though the exposure draft published last year only went so far in this regard. UCITS IV was also intended to address other issues arising under the current UCITS regime, such as the removal of administrative barriers to cross-border marketing and the reworking of the simplified prospectus. Plans to publish a draft Directive have been put on hold. This reflects opposition from some Member States (notably Ireland and Luxembourg) to the idea of a full management company passport.

Other relevant developments

- The Hedge Fund Working Group has set out best practice standards for the hedge fund industry. The standards build on the FSA’s Principles for Business, and focus on risk management, valuation and disclosure requirements.
- The FSA is reviewing the controls put in place by hedge fund managers to prevent, detect and deter market abuse.
- Firms in the UK are expected to review their systems and controls to protect against “rogue trader” risk. Larger institutions in the UK appear to have done this without prompting by the FSA.

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*A high level summary of a presentation made by Martyn Hopper and Patrick Buckingham to the ICMA Asset Management and Investors Council in Zurich in June.

The legal documentation for the repo market

The European Repo Committee has clearly contributed to the repo market over recent years, particularly through its efforts to standardise the legal documentation that the industry uses. As a result, the repo market has a degree of surety in the form of a market standard agreement that is widely used by repo market practitioners. In the past, legal risk was generally managed on the repo desk alongside trading risk and interest rate risk. The introduction of standardisation and the development

of a single legal agreement has been a significant step forward for the market. There is now legal certainty in a wide list of countries, which makes business much easier for both existing market participants and new market entrants. In the market turbulence of the past year there has been little or no problem as regards the legal protection given by the Global Master Repurchase Agreement (GMRA).

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Legal opinions on the GMRA

On 28 April, ICMA published the 2008 legal opinions on the [Global Master Repurchase Agreement \(GMRA\)](#), the standard agreement used for international repo transactions. The opinions now support the use of the GMRA in 68 jurisdictions.

Opinion seeking exercise to date: In past years, ICMA obtained and annually updated legal opinions on the GMRA from numerous jurisdictions worldwide. In some of these jurisdictions the opinions were jointly obtained and updated with the Securities Industry and Financial Markets Association (SIFMA).

Combination of opinion seeking exercises by ICMA, SIFMA and the SLRC with effect from 2008: In autumn 2007, ICMA, SIFMA and the Securities Lending and Repo Committee Capital Adequacy Working Group (SLRC) agreed, in a decision endorsed by the International Securities Lending Association (ISLA), to combine the legal opinion updating exercises conducted separately in the past on the GMRA on the one hand and the securities lending agreements² (collectively the “SLAs”) on the other and to seek combined opinions

on the GMRA and the SLAs on an annual basis with effect from 2008.

Format of the combined opinions: The combined opinions consist of the following parts:

- (i) core opinion covering both the GMRA as well as the SLAs (the “Core Opinion”);
- (ii) specific appendix covering the GMRA (the “GMRA part”); and
- (iii) specific appendix covering the SLAs (the “SLAs part”).

Availability of combined opinions: ICMA makes available to its members and associate members the Core Opinion together with the GMRA part. The Core Opinion together with the SLAs part is available on subscription from the Freshfields Bruckhaus Deringer LLP SLRC Extranet in London (for further information contact kbdsupport@freshfields.com).

Management of the combined opinion seeking exercise: The overall management of the combined opinion seeking exercise is undertaken by ICMA and the review of all opinions produced by local counsel

is conducted by Freshfields Bruckhaus Deringer LLP in London. ICMA, SIFMA and the SLRC agreed, in a decision endorsed by ISLA, on an annual review cycle and the completion of the annual review of the combined opinions by 31 March.

2008 opinions on the GMRA: ICMA obtained the 2008 update opinions in 58 jurisdictions (of which 53 are combined opinions consisting of the Core Opinion and the GMRA part) and for 10 new jurisdictions (of which eight are combined opinions consisting of the Core Opinion and the GMRA part). ICMA members and associate members only may download the opinions from [ICMA's website](#).

Prospective new opinions on the GMRA and the SLAs: ICMA and the SLRC are currently jointly seeking new opinions for Oman and Qatar. ICMA is also seeking a new opinion for Malaysia and is establishing whether clean opinions can be obtained for Bulgaria and Romania.

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²Overseas Securities Lender's Agreement (October 1994 version), Overseas Securities Lender's Agreement (December 1995 version), Master Gilt Edged Stock Lending Agreement (1996 versions) and the Global Master Securities Lending Agreement (May 2000 version)

European repo market survey

The 15th ICMA–European Repo Council survey of the repo market in Europe will be published on 9 September 2008. This latest survey, which will provide a “snapshot” of repo business at close of business on Wednesday, 11 June 2008, is still open for contributions from banks in Europe transacting repo business. The [forms and guidance notes](#) for participation in the survey can be found on ICMA's website. For any queries regarding the survey, contact the author at reposurvey@icmagroup.org.

The results of the survey will be presented at the next European Repo Council meeting in London on 9 September. Full details and an agenda are available from the [ICMA website](#).

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International Securities: Market Practice Book Green Paper

In the [April edition](#) of this Newsletter, we described the role of the International Securities Market Advisory Group (ISMAG), which was set up by the International Central Securities Depositories (ICSDs) with the aim of developing standards for the servicing of international securities deposited with the ICSDs. The ISMAG has published, on the [Euroclear](#) and [Clearstream](#) websites, for consultation a Green Paper on an operational Market Practice Book (MPB). ICMA will be commenting on the MPB Green Paper. The ICSDs hope that a White Paper can be published in the autumn.

For further information on ISMAG and the MPB Green Paper, please see the [Euroclear](#) and [Clearstream](#) websites.

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Members of the European Repo Committee on The Advantages of Secured Finance Panel at the ICMA conference in Vienna on 16 May.

The 40th ICMA AGM and Conference, Vienna, 2008

Over 550 delegates gathered at the Vienna Hilton for ICMA's 40th AGM and Conference in May. Although the emphasis of the Conference sessions was firmly on the issues facing the global capital markets today, there was time to look back on how much the market has changed and grown over the four decades since the Association's first meeting. The scene was set with a short film featuring some of the luminaries of the international capital market in its earlier years such as Stanislas Yassukovich, Stanley Ross, Eugene Rotberg, Rupert Hambro, Ian Plenderleith, Minos Zombanakis and Sir David Walker, describing the post-war rise to prominence of the first truly international market for raising capital and the innovations and the environment that made its success possible.



Following this retrospective, which included some reflections on financial crises of past years, delegates heard a keynote address from Jean-Claude Trichet, President of the European Central Bank, on ongoing market turbulence and the response of the central banking community. The other conference sessions covered diverse themes: amongst them, financial stability and the risks to capital markets; market transparency; realignment of the short term debt market; the advantages of secured finance; and the changing role of investors. But all touched to a greater or lesser degree on the current challenges facing global financial markets.

The [film retrospective of the last 40 years](#) and also [webcasts of all the panel discussions](#) can be viewed from the ICMA website.



ICMA's thanks go to all the sponsors who made the event so successful. The 41st AGM and Conference in 2009 will be held in Switzerland.



New Executive Education courses

Having successfully established the core ICMA certification courses, the introductory Foundation Course and Intermediate Courses (IFID, OCP and PMC), the next step for ICMA Executive Education is to extend its range of “third level” programmes with a variety of short (1 to 3 days) courses on single topics. These are all logical extensions of topics introduced in either the IFID or OCP and will be offered from September 2008.

Market courses (IFID stream), created by Neil Schofield, Visiting Fellow, ICMA Centre include:

- commodities and commodity derivatives
- inflation linked securities and derivatives

Operations courses (OCP stream), created by Keith Dickinson, Visiting Fellow, ICMA Centre include:

- funds administration
- corporate actions

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Primary Market Certificate course in Bahrain

As anticipated in the [April edition](#) of this Newsletter, ICMA will be delivering, in conjunction with the Bahrain Institute of Banking & Finance and with the support of the Central Bank of Bahrain and the International Islamic Financial Market, a primary market practices course with coverage of the growing sukuk market.

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ICMA Executive Education courses

Financial Markets Foundation Course (FMFC)

16 to 18 September 2008
 Luxembourg

International Fixed Income and Derivatives Certificate Programme (IFID)

19 to 25 October 2008
 Budapest, Hungary

Primary Market Certificate (PMC)

17 to 21 November 2008
 London, UK

Operations Certificate Programme (OCP)

29 March to 4 April 2009
 Montreux, Switzerland

International Fixed Income and Derivatives Certificate Programme (IFID)

26 April to 2 May 2009
 Sitges, Spain

ICMA Skills courses

Successful Sales

3 to 5 September 2008
 London

Mastering Mandates

2 to 4 December 2008
 London

Management and Mentoring

9 to 11 December 2008
 London

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