ICMA

International Capital Market Association

ICMA Regulatory Policy Newsletter

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Editor: Paul Richards

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Restoring market confidence

The period of market turbulence since August last year has been the most testing time that market participants can remember. It has led to a severe loss of market confidence. As a result, banks have become reluctant to lend to each other, except for very short periods and on onerous terms, and the interbank market has ceased to function properly. The loss of market confidence matters, because it is seriously undermining the stability of the international financial system, destroying wealth on a massive scale and turning the prospects for growth in the international economy into recession. What can be done to restore market confidence and ensure that markets function properly, and what in particular can be done to re-establish liquidity in the interbank market?

Action by the authorities is a necessary condition for restoring market confidence. Central banks may be able to help restore market confidence by reducing interest rates, without jeopardising their inflation targets given the recessionary outlook, as they did on a coordinated basis on 8 October. Central banks are also continuing to play a critical role in providing the liquidity the market needs: for example, by frontloading the provision of liquidity during monthly maintenance periods, extending maturities, broadening the range of eligible collateral they are willing to accept in exchange, broadening their range of counterparties and even experimenting by lending unsecured.

When the solvency of a financial institution is threatened, the authorities have to decide whether the institution is too large or too interconnected to fail, or whether its rescue will create moral hazard in the future. In the US, where a number of financial institutions have been rescued, the failure of Lehman Brothers has had a knock-on effect on market confidence. The US authorities' proposals to establish a Troubled Asset Relief Program are designed to help restore market confidence *inter alia* by removing "toxic" assets from banks' balance sheets.

In Europe, under a major comprehensive and coordinated new plan, individual Member States have taken steps to help restore market confidence by: increasing the level of government guarantees on retail bank deposits, and in some cases removing the limits altogether; offering to guarantee the refinancing of maturing wholesale funding to help restart the interbank market; providing, and underwriting the provision of, new capital to banks requiring recapitalisation;

René Karsenti
Executive President,
ICMA

and setting up emergency funds to buy assets from banks. In return for putting taxpayers' money at risk to rescue banks in these ways, the governments of Member States are asking senior bank management to take full responsibility for past actions, limit executive pay in future and potentially restrict dividends to shareholders, while seeking a return for taxpayers. Where a number of Member States together take steps to recapitalise banks, this may also provide a pointer to the unresolved question in Europe about how a large cross-border rescue would be organised and who would pay for it.

Separately, the authorities have to decide whether more regulation would help to restore market confidence. More regulation does not necessarily mean better regulation: new regulation needs to be considered carefully in advance to avoid unintended consequences later. For example, it is important to restore confidence in the process of setting credit ratings. But any approach to supervising credit rating agencies should be tackled globally; and if there is a risk of political interference in the ratings process, this will tend to undermine market confidence rather than help to restore it. Similarly, the market needs to re-examine the originate-to-distribute model. But European Commission proposals to force EU originators to keep their "skin in the game" risk harming EU competitiveness.

Although the authorities' role is necessary in helping to restore market confidence, it is not sufficient on its own. The financial services industry itself has a vital part to play. This is mainly a matter for individual financial institutions themselves. A number have succeeded in raising new capital from their shareholders or from new investors, such as sovereign wealth funds. Consolidation has been taking place across the industry in the interests of achieving safety in strong balance sheets. In some cases, consolidation is being facilitated by the authorities: for example, by providing limited official guarantees or by waiving competition concerns. And the remaining independent global investment banks have opted to apply for full banking licences in the US, thereby submitting to stricter prudential regulation.

Financial institutions can also help to restore market confidence and ensure that markets function properly by addressing difficult issues in common: by ensuring maximum disclosure to investors; and by considering how to value securities when financial markets are closed, for example by allowing more flexibility in applying mark-to-market accounting in an attempt to prevent a downward spiral in asset prices. This involves a continuous dialogue between issuers and investors, and between the industry and the authorities. Trade associations like ICMA are playing a significant role in these areas, and are actively engaging with central banks, the Commission, CESR and national regulators on their members' behalf.

ICMA also has an important self-regulatory role. ICMA and its members have for many years been centrally involved in creating an efficient and well functioning market through setting voluntary standards of good market practice. It is not widely appreciated how resilient the financial and legal market infrastructure has been during the recent period of market turbulence. I believe that ICMA's self-regulatory role in establishing and maintaining orderly markets by applying standard market practice across borders continues to deliver benefits in terms of flexibility, efficiency and cost-effectiveness.

Restoring proper functioning of the market is an essential first step to restoring market confidence, and the top priority is to re-establish liquidity in the interbank market. I welcome the steps that the authorities have already taken in an attempt to restore market confidence, especially when they have acted together. But given the scale of the emergency we face, I personally think that three additional steps need urgently to be considered:

First, we should build on government proposals to set up emergency funds to buy "toxic" assets from banks by encouraging banks to ring-fence the toxic assets on their balance sheets.

Second, we should build on the proposals by ECOFIN in Europe and the SEC in the US to allow more flexibility in mark-to-market accounting by permitting banks, if they choose, temporarily to suspend their use of mark-to-market accounting.

Third, the creation of a central clearing counterparty for credit default swaps should be implemented as soon as possible to help a proper functioning of the derivatives market.

René Karsenti
Executive President, ICMA

ICMA's commitment to orderly markets

In the current turbulent market conditions, ICMA remains committed to helping its members to maintain orderly markets. ICMA and its members have for many years played a key role in ensuring efficient and well functioning markets through setting standards of good market practice. These focus on market mechanics and other technical issues. They are kept up to date in consultation with ICMA's committees of members.

ICMA is responding to members' questions on its Primary Market Handbook, its Rules and Recommendations in the Secondary Market and on the Global Master Repurchase Agreement. If members have questions on the Primary Market Handbook, please contact Ruari Ewing at ICMA Ltd on ruari.ewing@icmagroup.org. If members have questions on the Secondary Market Rules and Recommendations or on the Global Master Repurchase Agreement, please contact Lisa Cleary on lisa.cleary@icmagroup.org.

ICMA welcomes feedback and comments on the issues raised in the Regulatory Policy Newsletter. Please e-mail: regulatorypolicynews@icmagroup.org or alternatively the ICMA contact whose e-mail address is given at the end of the relevant article.

Self regulation: sometimes controversial, always necessary

There is no simple answer to the question, "What is self regulation?"

In 2006 the International Council of Securities Associations (ICSA), of which ICMA is a member, defined Self Regulatory Organisations (SROs) by reference to several criteria. According to ICSA, SROs are private non-governmental entities that:

- are dedicated to the public interest objectives of enhancing market integrity, investor protection and market efficiency;
- establish rules and regulations that effectively promote market integrity, market efficiency and enhance investor protection;
- establish and maintain an effective consultation programme in order to ensure that market participants have input into regulatory policies and procedures;
- monitor and enforce compliance with their rules and regulations and, where applicable, with other governing regulations;
- have statutory regulatory authority delegated to them by the government regulator;
- are supervised by the government regulator;
- have a professional staff with the appropriate training and resources;
- ensure that market participants and qualified independent directors have a meaningful role in their governance;
- establish and maintain appropriate structures, policies and procedures to ensure that potential conflicts of interest between regulatory and commercial and/or advocacy activities are appropriately managed.

The standard setter for the regulation of securities markets, the International Organisation of Securities Associations (IOSCO), published a paper prepared by its SRO Consultative Committee (SROCC) in 2000 which set out the benefits of self regulation*:

- Self regulation has a long history of working effectively.
- SROs possess flexibility to adapt to regulatory requirements of a rapidly changing business environment.
- SRO contractual relationships can reach across international boundaries.
- Industry input and representation contribute to a strong and effective compliance culture.
- Self regulation generally imposes fewer costs than government regulation.
- SROs provide an intimate knowledge of the markets and products.

It will be readily apparent that ICMA has for many years provided these benefits to its members and the international debt markets. In recognition of this, ICMA has been a long-standing member of the SROCC which has a total membership of 65 entities from around the world.

So why is self regulation controversial?

The principal reason is that in the minds of many legislators and regulators self regulation has been taken to mean the pursuit of self interest by market participants, whether by erecting barriers to entry, improperly favouring one group of market participants or preventing price competition in the provision of services to investors and issuers. This was evident in the United States with the SEC-mandated merger of the member regulation divisions of NASD and the NYSE in July 2007 to form the independent SRO, FINRA. This followed alleged fixing of minimum spreads in the OTC equity market by dealers and repeated abuse of their role in price formation by some of the NYSE's specialists.

Globally the privatisation of many stock exchanges and their conversion into "for profit" enterprises responsible primarily to non-user shareholders has caused some regulators to query whether such enterprises are still capable of meeting the public interest objectives of enhancing market integrity, investor protection and market efficiency.

However, simultaneously, the limits to statutory regulation have become increasingly evident. Scarce resources among statutory regulators, resulting in limited skill sets and lack of understanding of how markets work have caused some regulators to re-assess their opposition to self regulation.

Furthermore, different types of entities have begun to demonstrate legitimate claims to be self regulators. In addition to stock exchanges and other entities such as FINRA to which governments have formally delegated self-regulatory responsibilities, a range of professional associations which traditionally have merely represented their members' interests are increasingly developing codes of conduct which in some cases regulators have begun to use in disciplinary cases. An example in the UK is the eleven associations (including ICMA) which came together to form MiFID Connect in order to provide, collectively, guidance to their members on how to comply with the detailed requirements of key sections of MiFID.

The way forward

The recent market turbulence has raised many questions about the effectiveness of statutory and self regulation. Whatever changes result from the work currently being undertaken in many fora, domestic and international, ICMA will continue to argue for the benefits to issuers and investors created by enabling a major role for its members in the (self) regulation of the international debt market.

Contact: Richard Britton
richard.britton@icmagroup.org

** Model for Effective Regulation: IOSCO SROCC May 2000*

Updating ICMA's Rules and Recommendations in the Secondary Market

Michael Ridley, JP Morgan

With the agreement of the ICMA Board, in March we set up a Secondary Market Working Group, chaired by Michael Ridley of JPMorgan, to make proposals on updating ICMA's Rules and Recommendations in the Secondary Market (Section V of the Rulebook). The TRAX provisions on transaction matching, reporting and confirmation were excluded from the terms of reference of the Working Group.

The Working Group has been open to ICMA member firms willing to contribute. Three meetings have been held at JPMorgan, as a result of which: participating member firms have reviewed the current Rules and Recommendations; each member firm has put forward its own suggestions for revisions; these suggestions have been discussed in the Working Group; where there has been a consensus on proposing changes, member firms have been asked to propose drafting; and a consensus has been sought on the revisions proposed. Subject to further comments, the main changes likely to be recommended by the Working Group are set out in the Box.

The Working Group is likely to propose that the status of the Rules and Recommendations should remain unchanged, as this is important for ICMA in maintaining its self-regulatory status in the UK and Switzerland. It has also become apparent that most members of the Working Group, in consultation with colleagues, find the mix of Rules and Recommendations of considerable day-to-day use.

The next step is to consult other organisations with a potential interest to check that there is consistency across the market as a whole, and to check that the revised Rules and Recommendations comply with competition law.

Members with any further comments on the proposed revisions should contact Paul Richards, Andre Seiler or Kristin Selnes at ICMA.

Contacts: Paul Richards, Andre Seiler and Kristin Selnes
paul.richards@icmagroup.org
andre.seiler@icmagroup.org
kristin.selnes@icmagroup.org

Proposals for revisions to ICMA's Secondary Market Rules and Recommendations

General Section

Rule 2 Scope and application of rules: The Rule currently lists the currencies and types of securities that would qualify as an international security, but does not provide a definition. The Working Group is likely to propose that this should be replaced by a short definition of international securities, to the effect that an international security is a security intended to be traded on an international, cross-border basis and capable of settlement through an international central securities depository or equivalent.

Section 120 Dealing practices

Rule 121 "Odd lot" transactions: The Working Group is likely to propose that this Rule should be deleted as it is no longer valid.

Section 140 Multiple currency unit bonds

Rule 141 Choice and indication of currency: The Working Group is likely to propose that a new Recommendation is included where synthetic currency bonds are included in the definition of a multiple currency bond.

Section 180 Special terms and conditions/Special situations

Rule 181 Form of confirmation: The Working Group is likely to propose that Rule 181.2 (on odd-lots) and 3 (on contract notes) should be deleted, as they are no longer valid.

The Working Group is likely to propose that the Recommendation to Rule 181 should be moved to the General Section, as it deals with members' general obligation to comply with applicable local laws and regulations.

Rule 182 Special terms and conditions – non-fulfilment: The Working Group is likely to propose that this Rule should be amended so that, in the case of non-fulfilment by one party, the other party has the right to cancel the trade and claim any reasonably foreseeable costs.

Rule 183 Special situations - exercise of rights attached to securities or public offers: The Working Group is likely to propose that Rule 183.1 should be changed to read "public offer or solicitation" instead of "public offer".

The Working Group is also likely to propose that the Recommendation to Rule 183 should be changed by introducing a specific timeframe of "within five working days of the exercise of any rights attached to securities" instead of "when the deadline is approaching".

Rule 186 Change in basis of trading in the case of limit selling/buying orders: The Working Group is likely to propose that, when a change in the basis of trading from "plus accrued" to "flat" or from "flat" to "plus accrued" takes place, any unfilled limit orders should immediately be considered suspended.

Rule 187 Change of name of borrower: The Working Group is likely to propose that this Rule should be deleted, as it is considered superfluous.

Section 220 Value date

Rule 221 Value date new issues and Rule 222 Normal value date: The Working Group is likely to propose that the wording of these Rules should be clarified.

Section 250 Calculation of accrued interest

Rule 251 Accrued interest calculation: The Working Group is likely to propose that this Rule should be amended so as to make it clear that the default position for floating rate notes is the listed day count fraction, and to acknowledge that a different day count fraction may apply according to the prospectus.

Section 300 Settlement instructions

The Working Group is likely to propose that clarifying language should be added to recognise the fact that bonds may be issued in both materialised and dematerialised form.

The Working Group is also likely to propose that a new Rule – *Rule 303 Submission of settlement instructions* – should be added stating that instructions to the clearing agent must be submitted, whether or not the party is in possession of the securities.

Section 400 Refusal of delivery

Rule 401.1 Reasons for refusal of delivery: The Working Group is likely to propose that this Rule should be changed by adding, as a reason for refusal of delivery, that "the delivery agent is different from that contained in the notice".

Section 450 Buy-in and Section 480 Sell-out

The Working Group is likely to propose that both Sections should be amended by deleting any reference to pre-advice notice so that there is a one-step procedure instead of a two-step procedure.

The Working Group is also likely to propose amendments to define the responsibilities of the buy-in and sell-out agents more clearly.

Section 800 Miscellaneous

Rule 802 Shortages and/or discrepancies arising from security shipments: The Working Group is likely to propose that this Rule should be amended to allow the buyer or the buyer's agent a remedy period of 24 hours.

ECP benchmark

In conjunction with ICMA's ECP Committee, Euroclear announced on 7 October the launch of a free online service that displays average yields for Euro Commercial Paper (ECP) known as "Euroclear ECP Indices". This pioneering tool provides capital market professionals with weekly and daily computed yield data, sourced from Euroclear Bank as a neutral service provider, to track the evolution of the ECP market.

The weekly Euroclear ECP benchmark data, an industry first, will display five ECP investment grade categories, including financial, corporate and sovereign issues, with different maturity periods, or tenors, of one month and three months, in three currencies (euro, US dollars and pounds sterling). The daily Euroclear ECP benchmark data will provide average yield data only on the highest quality paper (ie A1/P1/F1 paper), for the same maturity periods and the same three currencies.

Market professionals will be able to quickly and easily download daily average weighted yields expressed in percentage format. The data are based on primary market ECP transactions settled at Euroclear Bank, calculated according to standard market practice for deriving annualised yield values.

Issuers may use the yield information to benchmark their ECP offerings, whereas investors may use them to compare investment opportunities. ECP dealers will also find the data of value to price paper that is entering the ECP market for the first time. (See chart.)

Contact: Paul Richards
paul.richards@icmagroup.org

Repo market developments

The latest ERC survey of the European Repo Market, which took place on 11 June, was published on 9 September. The headline figure for the European repo market size remained stable at €6,504 billion, a small increase from the December 2007 survey, demonstrating that the repo market has held up well despite continuing turbulence in the wholesale money markets. While the market as a whole has been robust, the survey indicates that individual participants have been affected by adverse conditions. While 19 institutions had expanded their repo book since the last survey, 41 had contracted their repo activity. This is the first time the survey has noted such a big negative imbalance in the expansion and contraction of institutions' repo books.

The survey was completed before the events of September. Immediately following the Lehman Brothers filing for Chapter 11 in the US and for administration in the UK, members of the European Repo Council were supported by ICMA's legal team who provided guidance and clarification in response to the application of the provisions of the Global Master Repurchase Agreement (GMRA). A FAQ document, which also covered the application of ICMA's Rulebook, was made available to ICMA members via the website. The GMRA has proved in these difficult circumstances to be a reliable and robust document. Any challenges over the unwinding of trades by Lehman have occurred not because of the legal framework but where there has been a lack of absolute clarity from the administrators.

Subsequent to recent market events the European Repo Council has a lengthening list of items which it will progress in the coming weeks. The ERC will be closely monitoring developments in the area of indices – LIBOR and EUREPO more particularly. Collateral management and liquidity management issues will also be a priority for the repo community. The ERC will continue to be engaged in European infrastructure projects, such as Target2-Securities and CCBM2. Together with the feedback from discussions at the European Commission and CESR, broad changes can be expected that will be key to the development of a pan-European repo market.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Asset management

At its latest meeting in September, the Asset Management and Investors Council (AMIC) discussed the impact of recent market turbulence on the asset management industry. The AMIC is the voice of ICMA's buy-side members, and its broad composition embraces the diversification and the current dynamics of the industry.

AMIC members raised four main issues of concern:

- first, liability-driven investment (LDI): it was agreed that counterparty risk needed careful consideration in current market conditions;
- second, money market funds: the AMIC is planning to publish a report on money market funds, taking into account recent events;
- third, market liquidity in current conditions;
- fourth, short selling (see the separate article in this edition of the Newsletter).

The AMIC will be meeting again in December in Brussels and is planning to discuss these issues with regulators based on reports produced by Council members which will be published on ICMA website.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Immediate responses to financial turmoil

On 7 October, the EU's Economic and Financial Affairs Council (ECOFIN) issued a statement on Immediate responses to financial turmoil. The statement said that ECOFIN had agreed to support systemic financial institutions and to take all necessary measures to enhance the soundness and stability of the banking system and protect the deposits of individual savers. To this end, ECOFIN stressed the appropriateness of recapitalisation of vulnerable systemically relevant financial institutions, in accordance with seven principles:

- Interventions should be timely and the support should, in principle, be temporary.
- ECOFIN would be watchful regarding the interests of taxpayers.
- Existing shareholders should bear the due consequences of the intervention.
- The government should be in a position to bring about a change of management.
- Management should not retain undue benefits – governments may have *inter alia* the power to intervene in remuneration.
- Legitimate interest of competitors must be protected, in particular through the state aids rules.
- Negative spillover effects should be avoided.

ECOFIN also noted the "flexibility in the application of mark to market valuation under IFRS as outlined in recent guidance from the IASB", and strongly recommended that supervisors and auditors apply the new guidance immediately. They urged the IASB and FASB to work together on the issue of asset reclassification, with the aim of appropriate measures being brought forward by the European Commission as soon as possible. They also indicated that they expected this issue to be solved by the end of October, with the objective to implement as of the third quarter.

In respect of the state aids regime, ECOFIN welcomed the Commission's commitment to shortly issue guidance setting out a broad framework within which to assess recapitalisation and guarantee schemes.

Finally, the statement said that all Member States had agreed to provide, for an initial period of at least one year, deposit guarantee protection for individuals of at least €50,000, acknowledging that many Member States had decided to raise their minimum to €100,000. The Commission was strongly urged to bring forward an appropriate proposal to promote convergence of deposit guarantee schemes.

Contact: Lalitha Colaco-Henry
lalitha.colaco-henry@icmagroup.org

Liquidity support

The FSA has published a Consultation Paper proposing an amendment to the Disclosure Rules and Transparency Rules Sourcebook (DTR). The proposed amendment would make it clear that a financial institution admitted to trading on a regulated market that is in receipt of liquidity support from a central bank may be able to delay the public disclosure of this fact. Under the EU's Market Abuse Directive, firms admitted to trading on a regulated market are obliged to disclose inside information to the market. There may be legitimate reasons for a financial institution in receipt of liquidity support to delay the disclosure of such support. Such a delay may be justified on the grounds that immediate disclosure could damage consumer confidence and exacerbate the existing liquidity problems of the institution. The proposal is not intended to grant an unconditional or indefinite delay to disclose and under certain circumstances immediate disclosure would still be required.

We submitted a response supporting the proposal on 30 September before the consultation closed.

Contact: Annina Niskanen
annina.niskanen@icmagroup.org

Credit rating agencies

In the April 2008 edition of our Newsletter, we reported on the intense debate on the role of credit rating agencies (CRAs). Since then, there have been a number of important developments both at global and European level.

In May, following a period of consultation, IOSCO published its revised Code of Conduct on Fundamentals for CRAs. It followed that up in September with a call for greater international coordination in the oversight of CRAs.

Meanwhile, Commissioner McCreevy, in a speech on 16 June, called for a regulatory solution at European level for the CRAs. Following this speech, the European Commission published two Consultation Papers on CRA regulation and institutions' excessive reliance on ratings.

There are a number of key points in the first proposal with respect to authorisation, operation and supervision on CRAs:

- CRAs should be subject to prior authorisation.
- CRAs should establish a review function responsible for periodically reviewing the methodologies and models they use and significant changes to them.
- CRAs should identify and eliminate or manage and disclose any actual or potential conflicts of interest that may influence the analyses and judgments of their analysts.
- CRAs should not issue a rating or should withdraw an existing rating if, among other matters, the rating is issued in respect of an entity from which the CRA receives more than 5% of its annual revenue.
- CRAs should ensure that employees approving credit ratings are not involved in providing credit rating services to the same rated entity (or related third party) for a period exceeding four years.
- CRAs should disclose whenever rating methodologies, models or key rating assumptions are changed.
- Rating categories attributed to structured finance instruments should be clearly differentiated from other rating categories.
- The home Member State may impose sanctions where the Directive/Regulation has not been complied with. These sanctions may include withdrawal or suspension of authorisation.

The key points in the second proposal on tackling the problem of excessive reliance on ratings are that:

- regulated and sophisticated investors should rely more on their own risk analysis;
- all published ratings should include "health-warnings" about the specific risks associated with investment; and
- references to ratings in EU financial regulations should be re-examined and revised where necessary.

ICMA, together with BBA and LIBA, has submitted a joint response to the Commission, which is also consistent with the response by SIFMA. In our response, we recommended that the Commission should:

- focus public policy action on the needs of users of credit ratings, which are to ensure that enough information is provided to users on the risks or factors that would result in volatility in ratings;
- avoid intrusive authorisation and conduct of business requirements that would add cost and diminish the usefulness of, and confidence in, ratings;
- bear in mind that intrusive requirements may give rise to moral hazard by encouraging investors to rely unduly on regulatory oversight of credit rating agencies;
- not propose an authorisation and regulatory regime which would be out of line with the actions of the authorities in the rest of the world, and which appears to go further than ECOFIN intended;
- build as far as possible on existing mechanisms for registration and supervision of CRAs;
- avoid the risk of political influence on the credit rating process.

The Commission gave only a very short period – from 31 July to 5 September – for consultation. Most respondents have criticised the Commission for not conducting the consultation in accordance with better regulation principles. In addition to the the short period of time for the consultation, there has been no market failure analysis, no consideration of the range of possible policy options, and limited involvement of stakeholders. The responses can be found here.

However, Commissioner McCreevy said in a speech on 9 September that he intends to propose a legally binding registration and external oversight regime whereby European regulators will supervise the policies and procedures followed by the CRAs. Reforms to the corporate and internal governance of CRAs will also be included. The proposal is now expected in November.

Contact: Kristin Selnes
kristin.selnes@icmagroup.org

CRD origination proposal

In April, the European Commission consulted on various amendments to the EU Capital Requirements Directives (CRD). In particular, the consultation proposed that originators should be required to retain a minimum 15% capital charge on the underlying assets regardless of the securitisation positions actually retained. The Commission argued that its proposal was "intended to reduce the capital incentives for originators to transfer all risks of a securitisation to investors. Originators would remain exposed to the securitisation and their incentives would thus be more aligned with those of investors."

The proposal was widely criticised. Many respondents felt that such a requirement would be ineffective and place EU banks that originated securitisations at a global competitive disadvantage. The comment was also made that the proposals appeared to be a response to recent market events, yet the market turbulence started while firms were still using the Basel I rules and there had been insufficient time for the new framework to be properly assessed.

At the end of June, the Commission consulted on a second proposal – to require an investing bank to be satisfied that an originator retains at least 10% of the securitised assets. The proposal applied to all originators, not just those in the EU. Additionally, the scope of the proposal extended to all credit risk transfer instruments (including, for example, syndicated loans and credit derivatives). Notably, this proposal was open for public consultation for a two week period only.

ICMA's response (which represented the views of both our buy-side and sell-side members) focused on: (1) how the proposal would increase the cost of capital for originators and distributors; (2) the lack of clarity regarding scope; and (3) the uncertainty surrounding how such a proposal would work.

At the beginning of August, the Commission published a summary of the 49 responses to the second proposal (which included 14 from Member States). While there was support for the Commission's general objective, the unanimous response was that the proposed approach would not achieve the stated objective. Many of the comments made in relation to the first proposal were repeated in response to the second. Many respondents cautioned that any amendments should reflect and compliment the work being carried out currently by the Basel Committee on Banking Supervision. Concern was also expressed about the potential extensive economic impact of the proposals. The effect on the balance sheet of originators would further restrict the liquidity and capacity of markets. It was also felt that the proposal did not effectively address the incentive problem. Many argued that greater transparency over originators' standards and collateral, improved risk management procedures and better due diligence would more effectively address concerns around the originate-to-distribute (OTD) model.

On 1 October, the Commission adopted a further proposal. Accordingly, the Commission is proposing that investors should be required to ensure that originators and sponsors retain a material share of the risks and in any event not less than 5% of the total, in respect of the more opaque credit risk transfer instruments. Additionally, for investors to have a thorough understanding of the underlying risks and the complex structural features of what they are buying, originators will be required to ensure that prospective investors have access to all relevant data on securitisations, including retention commitments. The proposals also require investors to document their proper management of the risks of their securitisation positions. Originators will also have to apply the same credit-granting criteria to exposures to be securitised as they apply to exposures to be held. Investors and originators that do not comply with these provisions will incur heavy capital charges.

The proposal will now pass to the European Parliament and the Council of Ministers for consideration.

Contact: Lalitha Colaco-Henry
lalitha.colaco-henry@icmagroup.org

Transparency as a regulatory tool

The FSA published Discussion Paper 08/3 on Transparency as a Regulatory Tool (DP) in May. In the DP, the FSA advocates use of transparency as a regulatory tool. While it will not disclose information that would infringe any statutory restrictions regarding confidential information, the FSA intends to "proactively disclose" information that it believes serves, rather than harms, the public interest. The FSA has drafted a Code of Practice on Regulatory Transparency. The DP attempts to apply this Code to a variety of matters including complaints handling, publication of non-fundamental Own Initiative Variations of Permission (OIVoPs), and publication of firms' capital requirements (amongst others). Even though the DP primarily focused on retail issues, the FSA does not rule out using transparency in respect of wholesale firms and markets. A copy of ICMA's response to the DP, which focused on the possible implications to wholesale firms and markets, is on the ICMA website.

Contact: Lalitha Colaco-Henry
lalitha.colaco-henry@icmagroup.org

Disclosure of contracts for difference

In July, the FSA published a Policy Update to CP 07/20 indicating that, even though there was no market failure (and it was mindful that excessive disclosure could cause market inefficiencies), it had decided to pursue "option 3" – (a general disclosure regime requiring disclosure of all contracts for difference (CfDs) over 5%) as there had been little support for "option 2" (a targeted disclosure regime with a safe harbour from disclosure for CfDs meeting certain criteria).

We understand that the FSA is looking to implement "option 3" (in terms of both the scope of exempted intermediaries and the encompassed instruments) by way of a broad principles-based approach. This approach would draw on suggestions by LIBA/ISDA for a self-certification based regime which allows regulated entities that are authorized to trade securities and derivatives referenced to securities in a client-serving capacity to be exempted from disclosure requirements with respect to positions or transactions which are client-serving in nature.

The Policy Update indicated: that the FSA would publish draft rules together with a Policy/Feedback Statement in September (now October); that final rules would be published by end-February 2009; and that the rules would take effect no later than September 2009. We understand there is pressure within the FSA to bring forward the implementation deadline. Accordingly, market participants have been encouraged to deliver to the FSA a convincing case to explain why they would need at least six months to develop the necessary monitoring systems and moreover why this time period could only start from the point of publication of the final rules.

It is worth noting that, while Directive 2007/36/EC (Shareholder Rights Directive) was formally adopted in June 2007, the issue of greater transparency with respect to stock lending is still outstanding with the Commission. Additionally, we understand that regulatory authorities in Ireland, the Netherlands and Germany are considering whether to require greater transparency in relation to cash-settled derivatives.

Contacts: Lalitha Colaco-Henry and Annina Niskanen
lalitha.colaco-henry@icmagroup.org
annina.niskanen@icmagroup.org

Short selling

Since June, short selling – or the practice of selling a financial instrument the seller has borrowed in the hope of repurchasing it later at a lower price – has attracted regulatory attention. Indeed, on 20 June, the FSA implemented its new regime. The FSA has amended its Market Conduct Sourcebook so that any trader who has a short selling position worth at least 0.25% of the issued shares of a company involved in a rights issue will have to disclose it.

Recent market events have prompted further regulatory action on short selling across the globe. The FSA and the SEC announced on the same day that they would take temporary emergency action to prohibit short selling in shares of financial companies to protect the integrity of the securities market. The FSA published a FAQ on its emergency measures. A number of regulators in other countries took similar steps.

CESR is coordinating action by national securities regulators in Europe on short selling of shares in financial companies, and monitoring regulatory developments across Europe on additional reporting obligations. A list of measures taken by national regulators in Europe is being kept up to date by CESR.

The measures put in place are currently intended to be temporary. ICMA's Asset Management and Investors Council (AMIC) will be monitoring closely that this is indeed the case.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Extension of the statutory regime for issuer liability

The question of whether and how far issuers of securities should be liable for damages for inaccurate statements made to the market upon which investors rely to their detriment is an important one but the answer is not obvious. Timely, comprehensive and complete reporting by issuers is a crucial element to promote the efficiency of capital markets.

The subject of the UK policy on issuer liability for disclosures arose during the implementation of the Transparency Directive into UK law. After consultation, the Government sought Parliamentary approval for a statutory liability regime that was established under section 90A of the Financial Services and Markets Act 2000 (FSMA), in the section inserted by the Companies Act 2006. HM Treasury was given power to make further provision about the liability of issuers.

These above mentioned powers provided scope for a thorough exploration of these issues. The Government asked Paul Davies, Professor at the London School of Economics, to carry out an independent review of liability in respect of damage or loss suffered as a consequence of inaccurate, false or misleading information disclosed by issuers or their management to the market, or of the failure to disclose relevant information to the market promptly or at all. As a result of Professor Davies' work, a broad consensus has emerged on the main issues, which underpins his recommendations to Government.

As a result of Professor Davies' report, HM Treasury has launched the Consultation, which covers the Government's response to his recommendations and proposes draft regulations to amend the regime. HM Treasury proposes to retain the current basis of liability, which is fraud. The regime is proposed to apply to "transferable securities" as defined in section 102A(3) of FSMA.

HM Treasury is proposing the following extensions to the statutory regime:

- to issuers with securities admitted to trading on UK multilateral trading facilities (MTFs), as well as those admitted to regulated markets;
- to issuers with securities admitted to trading on an EEA regulated market or MTF, provided they have a registered office in the UK or the UK is their home state under the Transparency Directive;
- to a broad range of *ad hoc* and periodic disclosures to markets by extending the regime to information disclosed by a recognised information service;
- to permit sellers of securities to recover losses incurred through reliance on fraudulent mis-statements;
- to permit recovery for losses resulting from dishonest delay of a disclosure.

The consultation closed on 9 October.

Contact: Annina Niskanen
annina.niskanen@icmagroup.org

MiFID transposition

In July, ICMA received an invitation from the European Commission to contribute to its MiFID Level 4 work. The four-level Lamfalussy process provided for the Commission to carry out a thorough assessment of the correctness of the transposition and application of MiFID in Member States, as part of the process aimed at ensuring the consistent implementation of the Directive.

ICMA's response to this Call for Evidence, compiling comments from our pan-European membership, focused on the legal implementation issues which present obstacles to the establishment of the European market for investment services, rather than looking at compliance issues that may have arisen since. In addition, ICMA members highlighted the fact that more time was needed to allow the market to develop before it would be possible fully to evaluate the MIFID provisions. The Call for Evidence covered themes such as MiFID authorisation, investor protection, competition between trading venues, transaction reporting and efficient supervision/cooperation among authorities.

In parallel with analysis of pan-European trade associations' responses as regards the legal implementation, the European Commission is planning to hold a one-day seminar on "MiFID implementation – one year on" on 13 November in Brussels. The conference is intended to promote a more generic discussion of the impact of MiFID in the European landscape. The event is public and registration can be made through the DG Markt website. ICMA will be moderating one of the panels.

CESR has also published three supervisory briefings on conflicts of interest, inducements, and best execution. These briefings are intended to promote convergence between supervisors but do not constitute new CESR policy.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Clearing and settlement

On 9 July, the Monitoring Group on the Code of Conduct (MOG) met to assess the implementation of the Code. The seventh meeting of the MOG took place in the context of the ECOFIN conclusions highlighting the importance of the Code and its functioning to Member States. The European Council is attaching particular importance to developments in the post trade area. The next MOG will be held on 29 October. That meeting will be in time for the Commission's next report to the Council under the French Presidency evaluating the Code of Conduct, which is due in November.

The Governing Council of the European Central Bank announced its decision to launch the Target2-Securities (T2S) project on 17 July. T2S is a single IT platform which will provide centralised settlement of euro-denominated securities. The system is also intended to be open to other currencies. The launch comes after the feedback received to the invitation sent by the Governing Council of the ECB on 23 May to all European central securities depositories to join the T2S initiative. Subject to certain conditions, almost all euro area CSDs are prepared to enter into a legally binding contractual arrangement by the end of the first quarter of 2009, and intend to use the service once it is in operation. The project is to be taken forward by the central banks of Germany, Spain, France and Italy.

The Legal Certainty Group (LCG) published in August its Second Advice on solutions to legal barriers related to post-trading within the EU to the European Commission. The LCG Advice looks at issues under three main themes: the technical requirements and business practices, taxation, and legal certainty. Three of the 15 Giovannini barriers have been reviewed: Barrier 13 on book-entry securities (Recommendation 1-11), Barrier 9 on the location of securities (Recommendation 15) and Barrier 3 on corporate actions processing (Recommendation 12-14). The European Commission will now analyse the proposals of the Second Advice, which is calling for harmonised legislation in this area of law, in view of taking a decision on the appropriate way forward before the end of 2008. The LCG will present its Second Advice in Brussels on 23 October.

Monitoring developments in the post-trading area, CESR's Post-Trading Expert Group has published in August 2008 a Call for Evidence on the identification of regulatory arrangements for post-trading infrastructures and on possible solutions in terms of bridging any potential differences in these arrangements. CESR's technical advice is expected to be published by December.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

Collateral management

At the beginning of 2007, the European Central Bank introduced a single list of eligible collateral common to all Eurosystem credit operations. Euro area credit claims (bank loans) became eligible for use as collateral under the single list – under the non-marketable securities categorisation – provided they fulfil conditions specified by the ECB.

On 24 April 2008, the Commission published a proposal to amend the Settlement Finality Directive and the Financial Collateral Directive – two of the main instruments relating to clearing and settlement in the EU. The aim of the proposal was to strengthen the resilience of settlement systems and financial collateral management. The European Parliament published its own draft report, which proposed *inter alia* an amendment revising the definition of collateral security so as to ensure consistency between the different Directives.

The ERC has closely monitored the development of this proposal, notably the proposed extension of eligible collateral classes to credit claims, a development that the ERC welcomes. It will also continue to monitor the opportunity for increasing the pool of securities and credit available for the collateralisation of market transactions.

Contact: Nathalie Aubry
nathalie.aubry@icmagroup.org

ICMA Primary Market Forum

Following the success of ICMA's 2007 Primary Market Forum, this year's event will bring together the international fixed income community, including borrowers, issuing banks, investors and law firms to debate the business issues and regulatory developments affecting the issuance of international debt.

Inevitably the central focus of the forum will be on recent market events and their impact on issuing trends, such as the increasing popularity of convertibles and equity hybrids, developments in covered bonds and the future of structured products.

The Forum will also include a session on the changing regulatory landscape, including proposed changes to the Capital Requirements Directive, the UK Special Resolution Regime, EU rating agency regulation and Prospectus Directive gold plating, amongst other initiatives. The need for global regulatory harmonisation and cooperation will also be considered.

The Primary Market Forum will take place in London on the afternoon of 11 November and is open to both members and non-members of ICMA. The event will be of interest to compliance officers, lawyers, syndication teams, borrowers, issuers and investors in the global capital markets.

Attendance at the event is free of charge but registration is required.

ICMA Autumn Events

German and EU Capital Markets - The New Competitive and Regulatory Landscape
16 October 2008
Frankfurt, Germany

Europe and Latin America - Working towards the Development of the Global Capital Market
27 to 28 October 2008
Sao Paulo, Brazil

ICMA Education Courses

International Fixed Income and Derivatives Certificate Programme (IFID)
19 to 25 October 2008
Sofitel, Budapest

Primary Market Certificate (PMC)
17 to 21 November 2008
London, UK

FINRA Programme in Compliance and Regulation - Presented in association with ICMA
25 to 26 November 2008
Zurich, Switzerland

Financial Markets Foundation Course (FMFC)
27 to 29 January 2009
London, UK

Financial Markets Foundation Course (FMFC)
2 to 4 March 2009
Luxembourg

Operations Certificate Programme (OCP)
29 March to 4 April 2009
Montreux, Switzerland

Published by:
Corporate Communications
International Capital
Market Association Limited
7 Limeharbour
GB-London E14 9NQ
Phone: +44 20 7538 5656
Fax: +44 20 7538 9073
info@icmagroup.org

New contact numbers from Monday 20 October 2008
Phone: + 44 20 7517 3220
Fax: + 44 20 7517 3221

ICMA Skills Courses

Mastering Mandates
2 to 4 December 2008
London, UK

Management and Mentoring
9 to 11 December 2008
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