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ICMA – one year on

Foreword by Martin Scheck, Chief Executive, ICMA

It is now almost a year since I started in this role at ICMA, and I would like to use this foreword to our quarterly market practice and regulatory policy assessment to share a few observations.

Compared to this time last year, the financial crisis has substantially worsened. Our focus at ICMA is on the efficient and orderly working of the cross-border securities markets, and as I write this it is crystal clear that the markets are, in general, not functioning as they should.

The sovereign debt markets have always been the bedrock of the debt capital markets – they have been the reference against which credit product is benchmarked; they are the markets which have traditionally had greatest liquidity; and their ratings in the past served as a cap for the ratings of domestic companies. So, to have the crisis migrate from the credit markets to the sovereign debt markets and to have much of the market break down is extremely disturbing.

Overall the lack of liquidity in the markets, the lack of reliable, tradeable secondary prices, the extreme volatility, lack of transparency in some instances, and the uncertainty surrounding the detail of new regulation, along with extreme reactions to unfounded rumour after unfounded rumour, has meant that this last year has seen the most difficult market conditions that most of us can remember.

All this is against a background where existing regulatory frameworks are being dismantled and then rebuilt – both nationally as in the case of the UK, and internationally: for example, the creation of the three European Supervisory Authorities and the European Systemic Risk Board. Regulation has become statutory and intrusive, and the entire market structure is being questioned: parts of the OTC markets are moving onto exchange and being cleared and settled centrally; new trading platforms and initiatives are springing up; and disclosure, transparency and consumer protection are playing an increasingly important role.

Martin Scheck

7 July 2010

ICMA – one year on - continued

What has this all meant for ICMA?

This last year has been a period both of reorganisation and modernisation, with an extra sharp focus on efficiency, and has been a period of immense activity for us. We have stuck steadfastly to our core objective of trying to make the cross-border securities markets more resilient and work more efficiently. With every new twist of the crisis we have worked with our members to analyse what that means for best practice, and where necessary to put out new or amended rules, recommendations or guidelines. Almost every single European directive relevant to the financial sector is being reviewed and revised, and new ones created – we analyse these, either proactively on the initiative of our councils and committees or in response to consultation papers or calls for evidence. This provides regulators and policy makers with industry-wide views on their proposals, so they can assess what will and what will not be effective. We have also broadened our representation of issuers, intermediaries and investors by increasing our membership overall, by building up our buy-side council and working groups which provide a forum for investors, by the creation of a new forum for financial issuers and a new group to look specifically at issues surrounding the difficulties in the sovereign debt markets.

I have spent a great deal of time in the last year talking with members and listening to their concerns, and there are a number of key themes.

All are concerned to get clarity on capital and liquidity requirements as soon as possible. All are concerned about the imposition of multiple layers of regulation, one on top of another. There is also tremendous concern that they will be faced with a plethora of uncoordinated regulatory reforms at national level, rather than a harmonised framework – ideally globally or, if not, at least on a European level. There is also a consensus that, despite constructive dialogue with regulators, the industry needs to rehabilitate itself, in the eyes of politicians – where dialogue and trust are at a low ebb – and with the general public, by demonstrating convincingly that what the industry provides does indeed add value for the entire population.

ICMA's role is to represent its members and to take practical steps in improving the securities market, and the current environment merely highlights the tremendous importance of this. We have seen an increased level of engagement of our members on our councils and committees – the work of these groups is well defined and highly relevant to our members. There is an increasing understanding that what we do, both in terms of market practice and our dialogue with regulators adds value for our members' day-to-day business.

ICMA has been playing its part in trying – hard – to restore orderly cross-border securities markets for issuers, intermediaries and investors during the last year and will continue to do so.

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The sovereign debt crisis in Europe

The main concerns in the international capital market about sovereign debt in Europe are of three kinds:

- First, there is concern that Greece has recently not been able to finance its public sector deficit and maturing debt in the bond market, despite very high yields; and that the problem may spread from Greece to other countries, particularly in (though not necessarily limited to) the rest of the euro area. Although the European Commission's spring forecast of the average general government deficit for the euro area (6.6% of GDP) and its level of gross debt (85% of GDP) in 2010 are not high by international standards, the deficit and debt in some countries, such as Greece (9.3% and 125% respectively), are much higher than the average.
- Second, there is concern about the scale of commercial bank exposure to sovereign debt in the euro area; and more broadly about the potential need for governments to provide additional capital or guarantees to support selected banks which face losses on their exposure – not only to sovereign debt but also on their loans to the private sector – and which have experienced funding difficulties as a result. For example, the BIS estimates that banks headquartered in the euro area had foreign exposure equivalent to $1,579 billion to borrowers in Greece, Ireland, Portugal and Spain at the end of 2009, of which $254 billion (16%) represented foreign claims on the public sector; and these banks represented 62% of all internationally active banks' foreign exposure to borrowers in the four countries. The continuing programme of stress tests for banks may help to make their underlying position more transparent.
- Third, these concerns have reopened old arguments about whether the euro area is an "optimum currency area", as it combines national economies with different characteristics and levels of competitiveness; whether monetary union can function effectively in the medium term without fiscal union; and what fiscal union means in the context of the euro area.

This article summarises the short-term measures which the European authorities have taken in response to the crisis and their plans for longer-term adjustment. As a contribution to the adjustment effort, restructuring of sovereign debt has been ruled out by the authorities for the foreseeable future. In response to questions from our members, the ICMA Board has decided that it would be prudent to set up a Sovereign Bond Working Group of market experts to undertake contingency planning on how restructuring might work in practice, in case it subsequently proves to be necessary.

Financing in the short term

Despite initial delays, the European authorities – in collaboration with the IMF – have now responded to the crisis by agreeing a specific package of financial support amounting to €110 billion for Greece, and a more general package amounting to an additional €750 billion in the hope of pre-empting problems elsewhere in the euro area. These measures – both in Greece and elsewhere, if needed and provided – will help finance public sector deficits and refinance maturing debt in the short to medium term, though they have raised questions about consistency with the "no bail out" provisions in the Maastricht Treaty:

- The €750 billion package consists of three elements: €60 billion from an increase in an existing EU budgetary facility; €440 billion from a new European Financial Stability Facility (EFSF); and up to €250 billion in IMF support. In the case of the €440 billion EFSF, which is incorporated in Luxembourg and designed to last for three years, euro-area members have agreed to provide individual (not joint) guarantees – in the proportions of their respective capital shares in the ECB – for the issue of bonds by a special purpose vehicle.[1] Drawings on the EFSF are subject to conditions. If a member draws on the EFSF, it is no longer in a position to provide funding for the facility, so the overall amount available for funding is reduced as the number of countries requiring funding increases.[2] The credit rating of the EFSF is due to be established shortly.[3]
- In addition to providing liquidity direct to euro-area banks, the ECB has decided to intervene in the secondary market for euro-area sovereign bonds. (Primary market purchases by the ECB are ruled out by the Treaty.) Some market experts are concerned that the ECB's decision may in practice lead to quantitative easing, and that this may ultimately compromise the independence of the ECB. But the ECB has denied

1 See also the article on "*A European Common Debt Programme: scope and purpose?*" by René Karsenti in the April edition of the ICMA Newsletter.

2 Each member is expected to guarantee 120% of its share in the EFSF.

3 While the EFSF facility is currently limited to 3 years, and the support package as a whole is currently limited to €750 billion, there is also a question whether it would become unlimited, if necessary. Effectively, in those circumstances, it would take the form of a "mutual defence pact" for the euro area.

this, and undertaken to sterilise the monetary effects of its purchases of government bonds (eg through the auction of one-week fixed-term deposits for the same amount). It is not yet clear how extensive the ECB's intervention in the secondary government bond market will be.

Adjustment in the longer term

The measures that have already been announced by the authorities provide short-term financial support, but they do not resolve the longer-term problem of fiscal adjustment needed in some euro-area countries. As regards longer-term adjustment, the President of the European Council is chairing a Task Force of EU Finance Ministers on euro-area governance. There are a number of questions which need to be addressed:

- How should surveillance of fiscal policies in the euro area be strengthened and surveillance made more independent (eg through independent monitoring of fiscal statistics) to prevent, and where necessary correct, excessive fiscal deficits and public debt, which are currently well in excess of the limits – 3% and 60% of GDP respectively – prescribed in the Stability and Growth Pact?
- How quickly should fiscal deficits and public debt be reduced, and what effect is the fiscal adjustment likely to have on real economic growth?
- If excessive fiscal deficits (beyond the 3% limit prescribed in the Stability and Growth Pact) remain, should sanctions be introduced; and if so what form should they take (eg withdrawal of EU funding, more stringent reporting requirements and suspension of voting rights); and would sanctions in practice be effective?
- Can surveillance of the internal and external competitiveness of the euro area be improved, and what difference would this make?
- Should an appropriate euro-area framework be designed for crisis management, building on the EFSF? If so, how would it work, and how would it minimise moral hazard?
- Should measures relate solely to the euro area, or should they apply selectively to the EU as a whole?
- Would an EU Treaty change be required, and would that be feasible given the experience with the last one?

Restructuring

To speed the adjustment of a sovereign debtor in emerging markets, an IMF programme often involves devaluation of the debtor country's exchange rate and debt restructuring (coordinated by the Paris and London Clubs). But the circumstances are different in the case of the euro area. Although the international competitiveness of the euro area as a whole can be improved by depreciation of the euro against the US dollar, devaluation of the exchange rate between one euro-area participant (like Greece) and others (including Germany) is not possible, and there are no provisions for exit from the euro area in the Maastricht Treaty.

If, despite the Treaty, a Member State took unilateral action to withdraw from the euro area (or was expelled), and decided to replace the euro with a new national currency, it is not at all clear how financial contracts currently denominated in euro would be treated. For example, would financial contracts written under its national law be redenominated in the new national currency, and financial contracts written under foreign (eg English) law continue to be denominated in euro? All that is clear is that euro exit – and anticipation of euro exit – would create acute uncertainty in the international capital market, and it would also risk a run on the banking system in the devaluing country or countries.

Restructuring sovereign debt is understood not to be part of Greece's current adjustment programme (though Greek public debt is expected by the European authorities to stabilise at 149% of GDP in 2013); and the European authorities have ruled out restructuring as an option for the foreseeable future. But the BIS states in its Annual Report on 28 June: "As the long history of sovereign debt crises has shown, when investors lose their confidence in a country's ability to service its debt and become unwilling to hold it, rescue packages, bailouts and even debt restructuring for the sovereign remain the only options." If restructuring ultimately proved to be necessary, clearly a coordinated European approach would be desirable (as in the case of the Paris and London Clubs in restructuring the debt of emerging economies).

Practical issues on restructuring

Any restructuring of the sovereign debt of a country in the euro area would raise questions both at macro and micro level. At *macro* level, what would be the impact of the sovereign debt restructuring of one euro-area country on other countries? Would ring-fencing of one country be possible (with the help of the European financial stability package), or would restructuring in one country precipitate the need for restructuring in others? And what would be the knock-on effects of the losses incurred by the banks on confidence in the financial system?

At *micro* level, how would restructuring work, if it proved to be necessary?

- First, there are the terms of the restructuring and the form it would take. It might involve lengthening the average maturity of the public debt. If it also involved a reduction in debt interest costs, this would impose a "haircut" on bondholders and other creditors. Restructuring would not necessarily involve a sovereign default, which might have other consequences (such as triggering CDS default clauses). An alternative might be a voluntary exchange offer to bondholders, though it is not clear what the incentive would be for bondholders to take up such an offer.
- Second, much the largest proportion of sovereign debt (eg in Greece) is issued under local law (ie the national law of the sovereign debtor) rather than foreign (eg English) law. There are a series of issues that arise for bondholders:
    - Sovereign bond issues under local law often provide less disclosure than under foreign law. (Sovereigns are exempt from the Prospectus Directive, though they can adhere to it voluntarily). Should there be more disclosure? Should it be clearer when bonds are issued under local rather than foreign law? Should there be a European EDGAR?[4]
    - Sovereign bond issues under local law often carry less protection for investors than issues under foreign law. Should protection for investors under local and foreign law be broadly the same? Is this realistic?
    - It is easier for sovereign debtors to change the terms of bond issues under local law than under foreign law, if they wish to facilitate restructuring, by introducing new legislation. In a restructuring, would bond issues under local law and issues under foreign law be treated the same?
- Third, if there is to be a restructuring involving sovereign bond issues under foreign law, the next question is how to consult, and obtain the agreement of, bondholders. Should it be necessary for all bondholders to agree, and should this be at a bondholder meeting? Unlike most bond issues under local law, many bond issues under foreign law have a collective action clause (CAC), which reduces the threshold for agreement. Should CACs be promoted, and is there an optimum threshold?
- Fourth, in the event of restructuring, should there be any preferred creditors? When restructuring takes place in emerging markets, bilateral official creditors are typically included, but the IMF itself is exempt. At European level, how would the ECB – as buyer of government bonds in the secondary market – be treated? Unlike the IMF, the ECB would hold the same bond issues as ordinary bondholders. Would they be treated in the same way in a restructuring? And would claims on the sovereign debtor by the special purpose vehicle of the EFSF be treated in the same way as claims by the ECB?

4 See the article on *European EDGAR* by Lalitha Colaco-Henry in the January edition of the ICMA Newsletter.

Next steps by ICMA

As prudent contingency planning on behalf of our members, ICMA has set up a Sovereign Bond Working Group under the Chairmanship of Robert Gray, ICMA's Vice-Chairman, to examine some of the micro issues that arise from potential restructuring in more detail. The Working Group is starting from the *Principles for Stable Capital Flows and Fair Debt Restructuring*, which were originally drawn up for emerging markets by the Institute of International Finance in conjunction with IPMA (now part of ICMA), and will consider how they might work in detail in practice, and whether they would need to be adapted, if they needed to be implemented in Europe. The focus will be on reviewing ICMA's existing rules and recommendations, and establishing good market practice in this area.

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Recent practical initiatives by ICMA

Regulatory response to the crisis

1 We are helping our members to respond to the sovereign debt crisis in Europe by implementing practical initiatives to make markets more efficient.

2 We have posted on our website a new webpage on sovereign debt information and (for members only) answers to frequently asked questions on sovereign debt restructuring.

3 Following a decision by the ICMA Board, a new Sovereign Bond Working Group is being established under the Chairmanship of Robert Gray of HSBC, Vice-Chairman of ICMA.

4 We have taken the chairs and representatives of ICMA's Regulatory Policy and Market Practice Committees to see the ECB, CESR and the Bank of England at a senior level to discuss international market developments and the authorities' response.

Short-term markets

5 The ICMA European Repo Council has submitted comments to the Basel Committee and the European Commission on their consultation papers on strengthening capital and liquidity regimes. The ICMA ECP Committee has also submitted comments to the Basel Committee and the European Commission on their related liquidity regime consultation papers.

6 The 2010 ICMA GMRA legal opinions covering 62 jurisdictions have recently been published on the ICMA website. This work has been overseen by the Legal Department.

Asset management

7 ICMA's Asset Management and Investors Council (AMIC), chaired by Robert Parker of Credit Suisse, took place in London on 28-29 June. Paul Tucker, Deputy Governor of the Bank of England, was the guest speaker at the AMIC dinner.

8 ICMA's Private Banking Working Group, meeting most recently in Basel in May and London in June, has made progress in drafting a Private Banking Charter of Quality.

Primary markets

9 A second Allocation Roundtable, bringing together representatives of ICMA's sell-side and buy-side members to discuss book building and allocation policy, was held held in London at BNP Paribas on 15 June.

10 The first meeting of the ICMA Issuer Forum, representing bank issuers, was held in London at Lloyds Banking Group on 28 June.

11 We are examining how we can best put the case for more disclosure of sovereign debt information, particularly for sovereign debt issues under local law.

12 We have continued to discuss, with the ICMA Euro Debt Market (AMTE) Council, the possible issue of guidance on the transparency of the different buyback policies of supranational and sovereign euro issuers.

Secondary markets

13 We received 69 completed responses from sell-side, buy-side and repo members to our secondary market electronic survey on corporate bond market liquidity and transparency, and have published the results on our website.

14 Using the results of the survey on corporate bond market liquidity and transparency, we have submitted our response to CESR on its technical advice to the Commission in the context of the MiFID review on non-equities markets transparency.

15 We have responded to a request by the Commission for information on the shorting of corporate bonds.

Market infrastructure

16 In consultation with the Operations Working Group of the ICMA ERC Committee, ICMA has responded to the IOSCO/CPSS guidance for CCPs and trade repositories.

17 ICMA's Euro Debt Market (AMTE) Council has discussed a possible change to ICMA's Rules and Recommendations in the secondary market to cover electronic trade confirmation in the OTC market.

Note for ICMA members

A conference call to discuss with ICMA members issues raised in this Newsletter, and to answer members' questions, is due to take place at 12.00 London time on Thursday 15 July. For further information, please contact Allan Malvar at: allan.malvar@icmagroup.org

G20 financial regulatory reform

On 8 and 9 April the International Monetary Fund (IMF) and Financial Stability Board (FSB) held a joint conference on *Implementing G20 Recommendations on Information Gaps*, as part of the consultation process to develop a concrete plan of action to implement the 20 recommendations in their October 2009 report.

The Communiqué from the 23 April meeting of G20 Finance Ministers and Central Bank Governors reaffirms their strong commitment fully to implement their reform agenda on the timelines agreed by the G20 leaders in London and Pittsburgh. Also dated 23 April, the Financial Stability Board (FSB) issued its *Report on Progress* in *Implementing the G20 Recommendations for Strengthening Financial Stability*. The progress report consists of two complementary parts: the first part on the policy development work at international level; and the second part describing implementation at national and regional levels by FSB member jurisdictions. A cover letter from the FSB Chair to the G20 highlights the areas in which progress is critical this year and next, to achieve credible, global regulatory reform. Various other documents relating to the IMF/World Bank spring meetings are also available, including the press briefing by IMF Managing Director Dominique Strauss-Kahn. The G20 Finance Ministers and Central Bank Governors then met again in Busan on 5 June and issued a further Communiqué. This followed a number of events highlighting the importance of sustainable public finances and the need for countries to put in place credible, growth-friendly measures, to deliver fiscal sustainability, differentiated for and tailored to national circumstances. Commitment was made to intensify efforts and to accelerate financial repair and reform.

The FSB held its latest plenary meeting on 14 June in Toronto, ahead of the 26-27 June G20 Toronto Summit. The meeting made enough progress for G20 leaders to make real decisions on financial reforms in Toronto, Chairman Mario Draghi said, though the formal press conference was cancelled as a result of a small fire at the venue. In the run-up to this FSB plenary, applicable updated documentation was released:

- *Ongoing and Recent Work Relevant to Sound Financial Systems*: a series of status reports, collated by the FSB Secretariat, on recent and ongoing work, accompanied by a cover note which highlights and summarises those initiatives started during the previous six months. The document also includes an overview table of major ongoing international regulatory initiatives, including information on their schedules for public consultation and target dates for finalisation; and
- *The Financial Crisis and Information Gaps: Progress Report – Action Plans and Timetables*: in November 2009 the G20 endorsed 20 recommendations to address information gaps described in the report, The Financial Crisis and Information Gaps, prepared by the FSB Secretariat and IMF staff. They requested the FSB Secretariat and the IMF staff to report back by June 2010 with a concrete plan of action, including a timetable, to address each of the outstanding recommendations in the report. This new report responds to that request. It includes a summary table of the progress to date, and the proposed action plans going forward, with timetables, in addressing the 20 G20 endorsed recommendations.

The conclusions from the 26-27 June Toronto G20 Summit were published in the form of a declaration, together with links to supporting IMF and World Bank reports. The Toronto Summit declaration includes points regarding the framework for strong, sustainable and balanced growth; financial sector reform; international financial institutions and development; and fighting protectionism and promoting trade and investment. Further details are included in annexes to the declaration. The reform agenda rests on four pillars:

- a strong regulatory framework, including a commitment to agree on a new capital framework at the Seoul Summit later this year;
- effective supervision, and the G20 leaders agreed to mandate the FSB and the IMF to report in October 2010 on recommendations to strengthen supervisory powers;
- resolution and addressing systemic institutions, including principles for powers and tools to restructure or resolve all types of financial institutions in crisis; and
- transparent international assessment and peer review in the form of a strengthened commitment to the IMF/World Bank Financial Sector Assessment Programme (FSAP) and peer review by the FSB.

There is also a related 27 June FSB press release, together with links to the FSB Chairman's letter to G20; the FSB's interim report on reducing the moral hazard posed by systemically important financial institutions; and the FSB's overview of progress in implementing the G20 recommendations. The G20 will meet next in Seoul, Korea, on 11-12 November 2010. It will then convene in November 2011 under the Chairmanship of France and in 2012 under the Chairmanship of Mexico.

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EU framework for crisis management

On 12 April, the ECB and the European Commission jointly held a high-level conference on financial integration and stability – details are linked from the ECB press release; and Michel Barnier's speech – "We need a European approach to crisis resolution" – is available (in French). On the same day, the ECB released its *Fourth Report on Financial Integration in Europe*, which notes the return towards integration in the European financial markets – including in-depth assessments of selected topics.

On 18 May, the ECOFIN Council met in Brussels and, *inter alia*, adopted conclusions on crisis prevention, management and resolution. These include:

- comprehensive reform of the EU framework to address crisis prevention, management and resolution challenges is needed to preserve the stability and the level playing field of the financial systems of the EU and Member States and to minimise overall costs;
- various components should support an enhanced EU policy coordination framework, including by mid-2011, for all large EU cross-border financial groups, establishment of Cross- Border Stability Groups alongside signed Cross-Border Cooperation Agreements;
- on enhancing the EU regulatory framework, ECOFIN supports the Commission's intention to present a Communication on crisis management in autumn 2010 and legal proposals by spring 2011 which will concentrate on establishing a holistic, coordinated and harmonised framework for preventative action, early intervention and resolution and with an initial focus on credit institutions and certain categories of investment firms; and
- further work is necessary at an EU and international level to enhance mechanisms to ensure the mitigation of systemic risk and that the financial sector bears the net costs of financial crises.

On 26 May, the Commission adopted a *Communication on Bank Resolution Funds*. This proposes that the EU establish an EU network of bank resolution funds to ensure that future bank failures are not at the cost of the taxpayer nor destabilise the financial system. Such funds would form part of a broader framework aimed at preventing a future financial crisis and strengthening the financial system. The Commission believes that a way to achieve this is by introducing requirements for Member States to establish funds according to common rules into which banks are required to pay a levy. The funds would not be used for bailing out or rescuing banks, but only to ensure that a bank's failure is managed in an orderly way and does not destabilise the financial system.

The related draft report of the European Parliament's rapportrice, Elisa Ferreira MEP, has also been published and is being debated – amendments most recently being considered at ECON's 21 June meeting.

With respect to crisis management the ECOFIN report on the *Preparation of the European Council* on *the State of Play on Measures in the Financial Sector in Response to the Crisis*, as agreed on 8 June, welcomed the Commission's intentions to come forward with:

- proposals for an enhanced, credible and better harmonised framework for deposit guarantee schemes, investor compensation Schemes and similar schemes in the insurance area as soon as possible this summer;
- a Communication setting out a detailed roadmap for an enhanced regulatory framework for crisis management in October; and
- a legislative proposal for that framework in early 2011.

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Reforming European financial supervision

As previously reported, in the latter part of 2009 the European Commission adopted an important package of draft legislation to create a new European Systemic Risk Board (ESRB) and also to set up a European System of Financial Supervisors (ESFS).

The package comprises proposals:

- for the establishment of the ESRB;
- regarding powers of the ESRB;
- for the establishment of a European Banking Authority (EBA);
- for the establishment of a European Insurance and Occupational Pensions Authority (EIOPA);
- for the establishment of a European Securities and Markets Authority (ESMA); and
- amending existing directives regarding powers of the three new European Supervisory Authorities (the "Omnibus" Directive).

This package has already been considered by the Council as particularly reflected in various ECOFIN conclusions and agreed Presidency compromise texts. Most recently, the conclusions from the 17 June European Council meeting included a statement that the European Council "calls on the Council and the European Parliament to rapidly adopt the legislative proposals on financial supervision to ensure that the European Systemic Risk Board and the three European Supervisory Authorities can begin working from the beginning of 2011". This reaffirms the political commitment to move ahead with the establishment of these new arrangements and this is a priority reflected in the work programme of the incoming Belgian EU Presidency.

The European Parliament's position has now also been developed, in particular through its Economic and Monetary Affairs Committee (ECON) – which in particular debated these proposals in its meeting on 10 May. As reflected in the press release following this meeting, in the Parliament's view "EU supervision must be much stronger than what the Commission and Council are proposing, in order to prevent the kind of slow and fragmented supervisory responses seen in the 2007-2008 crisis". Of particular relevance for securities markets, this press release goes on to say: "The text also provides for the possibility of temporarily banning a financial product if it is felt to pose too much risk. This power will be particularly relevant for ESMA, as it will be in a position to ban trading in a risky security. Finally, ESMA will be expected to advise on the supervision and regulation of credit rating agencies and clearing houses."

Trialogue negotiations between the European Council, Commission and Parliament are under way, to determine if a compromise text can be achieved in time for a first reading agreement soon enough to satisfy the political target to set this all up as of 2011.

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CRIS

The rapportrice of the CRIS committee, Pervenche Berès, presented the draft report to the Special Committee for the Financial, Economic and Social Crisis on 18 May. This covers the main effects of the crisis; its causes (including regulation and supervision); challenges; responses to date (including reform and regulation); and post-crash: sustainability and solidarity, investment and redistribution. The report was debated in the CRIS committee meeting of 3 June. Amendments have been tabled and will be considered prior to the committee's mid-July adoption of the report.

Amongst further special studies prepared for the CRIS committee is a June 2010 one entitled *Crisis Management, Burden Sharing and Solidarity Mechanisms in the EU*, which is a follow-up to a 2008 study, *Financial Supervision and Crisis Management in the EU*. This new study analyses some of the recent regulatory initiatives in response to the crisis and their implications for the EU financial system and economy. It indicates that, although EU policy makers are adopting important institutional reforms to create a more robust macro-prudential supervisory framework, serious gaps and weakness remain in EU regulation, crisis management, and burden sharing. Its conclusion is that in liberalised international financial markets it will always be very difficult for regulators to control systemic risks and that alternative regulatory approaches should be considered.

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Capital Requirements Directive

On 26 February, the European Commission launched a public consultation on further possible changes to the Capital Requirements Directive (CRD) aimed at strengthening the resilience of the banking sector and the financial system as a whole. The proposed changes, known as "CRD IV", following two earlier Commission proposals amending the CRD, relate to seven specific policy areas, most of which reflect commitments made by G20 leaders at Summits in London and Pittsburgh during 2009.

All interested stakeholders were invited to reply to the consultation by 16 April 2010, indicating what impact the potential changes would have on their activities; and over 150 responses have now been made available. The results will feed into a legislative proposal scheduled for the second half of 2010.

The possible changes set out in the consultation document are closely aligned with the forthcoming amendments to the Basel II framework and the introduction of a global liquidity standard that are currently being drawn up by the Basel Committee on Banking Supervision – which has also published responses to its 17 December 2009 consultation.

On 26 April 2010, the Commission hosted a public hearing on further possible changes to the CRD and to help develop its thinking, on 3 May the European Parliament's ECON Committee conducted a public hearing on Basel II and revision of the CRD. Dated 14 May, there is a draft ECON report from its rapporteur, Othmar Karas. The rapporteur is convinced that the crisis has set a clear case for an in-depth revision of the current regulatory framework; and therefore welcomes the efforts of the Basel Committee to upgrade the framework in general. Despite his general support to reform the framework, the rapporteur is however strongly concerned about visible shortcomings of the negotiation process on the revised framework; and that the framework, as currently presented, clearly puts the European economy at competitive disadvantage. The main reason for his draft report is therefore a call of the European Parliament on the Basel Committee to be included in the appropriate way in the ongoing negotiations; and a call to make necessary adjustments to the framework so that the European industry and economy are not disadvantaged. ECON continues its work on this report, most recently debating amendments in its 28 June meeting.

Amendments to the draft report of its rapportrice, Arlene McCarthy – as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies – were voted on at ECON's 14 June meeting, leading to a subsequently finalised report. The European Parliament's 30 June press release reports that the applicable negotiations between Council and Parliament have been concluded, paving the way for a July plenary vote for adoption. The finalised rules are expected to take effect in January 2011 for the bonus provisions and January 2012 for the capital requirements provisions.

On a related note, adjustments to the Basel II market risk framework were announced by the Basel Committee on 18 June. On timing, this announcement stated that the Committee has agreed to a coordinated start date of not later than 31 December 2011 for all elements of the July 2009 trading book package. As a result of these revisions, market risk capital requirements will increase by an estimated average of three to four times for large internationally active banks.

The possibility that the CRD may contribute to pro-cyclicality in the financial system led to the inclusion in the CRD of Article 156, which requires the Commission periodically to monitor whether the CRD has "significant effects on the economic cycle" and, in the light of the examination, submit a biennial report to the European Parliament and to the Council together with any appropriate remedial measures. Working with the ECB and the Committee of European Banking Supervisors (CEBS), such a report has just been prepared, along with supporting charts. Broadly speaking, the conclusion is that this analysis will help to inform those efforts to develop counter-cyclical measures that are already under way.

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Credit Rating Agencies (CRAs)

The EU's CRA Regulation entered into force on 7 December 2009. Article 41 governs entry into force, whilst Article 40 governs transitional provisions. Firms should recall the key date of 7 December 2010, from which their use of credit ratings will be constrained in accordance with Article 4(1).

Under mandate from the Commission, CESR is working on equivalence assessments for the US, Canada and Japan; and a mandate has been added to do so for Australia. CESR will submit its views in response to the Commission, following which the Commission will prepare any applicable equivalence proposals for formal EU approval. On 21 May, CESR published its advice on US equivalence. CESR concludes that, overall, the US legal and supervisory framework is broadly equivalent to the EU regulatory regime for CRAs in terms of achieving what CESR considers to be the overall objective. There are, however, a number of differences between the two regimes, which mainly relate to the issue of disclosure of credit ratings; and the quality of credit ratings and credit rating methodologies. CESR recommends the identified differences be addressed, through US Securities and Exchange Commission (SEC) changes, to allow for further convergence. On 9 June, CESR published its advice on Japanese equivalence. CESR concludes that there are no areas where the Japanese requirements do not meet the objectives of the EU requirements, there are no short comings, and as such CESR has no recommendations to make in respect of the Japanese legal and supervisory framework as a whole for the purposes of an equivalence determination by the European Commission.

Article 21 calls upon CESR to issue guidance on various items. Dated 17 May, CESR published two further sets of guidance in the field of CRAs, and invited comments by 18 June:

- Guidance on Common Standards for Assessment of Compliance of Credit Rating Methodologies with the Requirements set out in Article 8(3) (the responses to this consultation have been published); and
- Guidance on the Enforcement Practices and Activities to be Conducted under Article 21.3(a) of the Regulation (the responses to this consultation have been published).

CESR is required to issue these guidelines by 7 September 2010.

In addition, dated 4 June, CESR published two sets of guidance on the current CRA Regulation – Guidance on Registration Process, Functioning of Colleges, Mediation Protocol, Information set out in Annex II; and Guidelines for the implementation of the Central Repository (CEREP). This guidance is applicable from 7 June. CESR also published a feedback statement on the consultation held to develop the guidance on registration. It is useful to note the further FAQ issued by CESR on 4 June.

Dated 2 June, the Commission proposed improved EU supervision of CRAs. As rating services are not linked to a particular territory and the ratings issued by a CRA can be used by financial institutions all around Europe, the Commission is proposing a more centralised system for supervision of CRAs at EU level. Under the proposed changes, the new European supervisory authority – the European Securities and Markets Authority (ESMA) – would be entrusted with exclusive supervision powers over CRAs registered in the EU. This would include also the European subsidiaries of well-known CRAs such as Fitch, Moody's and Standard & Poor's. In addition, it is proposed that issuers of structured finance instruments such as credit institutions, banks and investment firms will also have to provide all other interested CRAs with access to the information they give to their own CRA, in order to enable them to issue unsolicited ratings (cf SEC rule 17g-5). The Commission's proposal will now pass to the EU Council of Ministers and the European Parliament for consideration. If adopted, the new rules would be expected to come into force during 2011.

Dated 7 May, the IOSCO Technical Committee has published for public comment its consultation report on *Regulatory Implementation of the Statement of Principles Regarding the Activities of Credit Rating Agencies;* and invited comments by 6 August. This report will be revised and finalised after consideration of all comments received, and a final report submitted to the Technical Committee for approval.

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Euro Commercial Paper (ECP) market

Liquidity rules: Official work to strengthen liquidity requirements continues. As previously noted, on 17 December the Basel Committee on Banking Supervision published consultative proposals to strengthen the resilience of the banking sector – including a consultative document on an *International Framework for Liquidity Risk Measurement, Standards and Monitoring*. There is much in this consultation paper with which the ICMA ECP Committee agrees, including that it is helpful to establish an internationally agreed standard covering liquidity risk. In its response to the Basel Committee, the ICMA ECP Committee articulated its belief that the characteristics of ECP are such that ECP represents an asset of appropriate quality for recognition as a liquid asset eligible for inclusion in the "broader category" of such assets that is under consideration; and respectfully requested the Basel Committee to recognise this in its finalised proposals.

On 26 February, the European Commission launched a public consultation on further possible changes to the Capital Requirements Directive (CRD) aimed at strengthening the resilience of the banking sector and the financial system as a whole. The proposed changes, known as CRD IV, following two earlier Commission proposals amending the CRD, relate to seven specific policy areas, most of which reflect commitments made by G20 leaders at Summits in London and Pittsburgh during 2009. The possible changes set out in the consultation document are closely aligned with the Basel Committee proposals. Accordingly, in its response to the European Commission, the ICMA ECP Committee expressed its support for consistency between the two sets of proposals and reiterated the points made in its Basel Committee response.

In a further development of central banks' financing requirements, the ECB confirmed in its 8 April press release that, as from 1 January 2011, the following instruments will no longer be eligible as collateral:

- marketable debt instruments denominated in currencies other than the euro, ie the US dollar, the pound sterling and the Japanese yen, and issued in the euro area; and
- debt instruments issued by credit institutions, which are traded on the accepted non-regulated markets.

This reverses exceptional measures that had been introduced to ease funding conditions and alters the relative attractiveness of Short-Term European Paper (STEP) labelling.

Money market funds are key investors for ECP, so the Committee continues to review the various official changes directly impacting such funds.

Dated 20 October 2009, CESR launched a consultation on a common definition of European money market funds. CESR subsequently posted the responses it received on its website, including the short one submitted by the ICMA ECP Committee. Following from this, on 19 May CESR announced the publication of its guidelines on a common definition of European money market funds and also published a feedback statement.

In summary, CESR's new guidelines set out a two-tiered approach for a definition of European money market funds. This approach recognises the distinction between "Short-Term Money Market Funds", which operate a very short weighted average maturity and weighted average life, and "Money Market Funds", which operate with a longer weighted average maturity and weighted average life. The guidelines apply to collective investment undertakings authorised under the UCITS Directive (2009/65/EC) and collective investment undertakings regulated under the national law of a Member State and which are subject to supervision and comply with risk-spreading rules. In both cases specific disclosure should be required to draw attention to the difference between the money market fund and investment in a bank deposit. The guidelines will enter into force in line with the transposition deadline for the revised UCITS Directive (1 July 2011) – however, money market funds that existed before 1 July 2011 are allowed a 6-month transitional period (until 31 December 2011). National authorities are generally expected to adopt a "copy out" approach to the guidelines, though some may pursue super-equivalent interpretations.

One impact of these changes is to push European money market funds to shorter-term investments. This comes at the same time as the new liquidity rules for European credit institutions (as discussed above) are pushing them to increase their longer dated funding and away from wholesale funding sources. These two well intentioned developments act to push apart investors and issuers, with potentially negative consequences for the efficient utilisation of monies held in money market funds. Reflecting its concern about this, ICMA's ECP Committee wrote a short letter, jointly with the Institutional Money Market Funds Association (IMMFA), explicitly to draw this matter to the attention of the European Commission, the UK FSA and the Bank of England.

In the US, the SEC announced its approved Money Market Fund reforms on 27 January. The applicable new rules largely came into effect in May, though certain requirements, particularly regarding disclosure, only take effect later this year. Meanwhile the consideration of more fundamental changes to the structure of money market funds continues, in particular with further proposals still awaited from the President's Working Group. In case these progress, this may in turn prompt more changes in Europe.

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European repo market

European Repo Council (ERC) White Paper: In recognition of the fact that there is a lot of work under way that needs to proceed from a well informed appreciation of a number of elements of the repo market's operation and infrastructure, the ERC Committee recently commissioned Richard Comotto to produce an ERC White Paper on the working of the repo market. This covers a wide range of repo market topics, including specials, shorts and fails. With respect to the latter it covers normal resolution mechanisms and the extra problems associated with low/negative interest rate environments. The White Paper then goes on to describe market infrastructures, identifying those features which are desirable for these to be robust. Existing problems, of which some have already been identified in meetings organised by the European Commission, are highlighted along with possible solutions and recommendations.

Liquidity: On 17 December 2009, consultative proposals to strengthen the resilience of the banking sector were announced by the Basel Committee. There is much in these proposals with which the ICMA ERC agrees, including that it is helpful to establish an internationally agreed standard covering liquidity risk. In its response to the Basel Committee, the ICMA ERC articulated its belief that the interests of all parties are best served if provisions applicable to repos are as efficient and effective as possible. In case the effect of well intended new measures proves to be a reduction in the attractiveness of repo markets, the consequence will be more risk and increasing financing costs, thereby harming the economic position of end-users – be they market participants or central banks conducting their monetary policy operations. The key points in the ERC's response can be summarised as follows:

- the use of CCPs to reduce counterparty credit risk is correctly being pursued, but leads to points of further detail which require to be carefully addressed;
- the correct measurement of exposure for leverage purposes should reflect netting; and
- the approach to the identification of "liquid assets" should proceed via a simple test: is the asset accepted as collateral for repos eligible for CCP clearing (by a CCP that fully conforms with the applicable standards promulgated by CPSS/IOSCO)?

Additionally, on 26 February, the European Commission launched a public consultation on further possible changes to the CRD, aimed at strengthening the resilience of the banking sector and the financial system as a whole. The possible changes set out in the consultation document are closely aligned with the Basel Committee proposals. Accordingly, in its response to the European Commission, the ICMA ERC expressed its support for consistency between the two sets of proposals and reiterated the points made in its Basel Committee response.

CCP standards: As announced on 12 May, IOSCO and the CPSS are now consulting on policy guidance on the application of the 2004 CPSS-IOSCO *Recommendations for Central Counterparties* (RCCP) to OTC derivatives central counterparties (CCPs). Applying the RCCP to OTC derivatives CCPs has involved a considerable degree of interpretation and judgment by relevant authorities. Furthermore, the CPSS and the Technical Committee of IOSCO recognise that there is now greater need for consistent application and implementation of the RCCP as well as closer cooperation between relevant authorities, as these CCPs tend to be more international in terms of cleared products and markets, participants and operations, reflecting the global nature of OTC derivatives markets. In light of recent experiences a working group has identified key new issues that arise when a CCP provides clearing services for OTC derivatives and developed guidance for such CCPs to address the unique characteristics of OTC derivatives products and markets.

The report also includes some limited guidance which aims to address issues that are not specific to OTC derivatives CCPs but are also relevant to CCPs for other types of products. This type of guidance is proposed in the report because the CPSS and IOSCO concluded that there is urgent need for such guidance on several issues in light of the lessons learned from the recent financial crisis. It should be noted, however, that work further to identify the need for this type of guidance will be part of the comprehensive review of RCCP and other international standards for financial market infrastructures (FMIs) announced in February – into which this report will be incorporated. Also, issues that are equally applicable to other types of FMIs than CCPs (including the issues concerning money settlements and liquidity resilience of CCPs and other types of FMIs; and risks arising from links among FMIs) are not discussed in this report.

The RCCP includes Recommendations concerning: (1) legal risk; (2) participation requirements; (3) measurement and management of credit exposures; (4) margin requirements; (5) financial resources; (6) default procedures; (7) custody and investment risk; (8) operational risk; (9) money settlements; (10) physical deliveries; (11) risks in links between CCPs; (12) efficiency; (13) governance; (14) transparency; and (15) regulation and oversight. This new report proposes tailored guidance in respect of each of these except Recommendations (7), (9), (10) and (11). Particularly in Europe it is important these recommendations align well with those of the ESCB/CESR. The ERC has submitted a response in which it has highlighted the importance of carefully considering those CCP issues that relate to products other than OTC derivatives; and expresses some concerns relating to the use of CCPs and the adequacy of collateral, where the level of increased demands may prove difficult to satisfy.

Greek auctions: The Electronic Secondary Securities Market (HDAT) is the regulated market for Greek government securities and bonds or other fixed-income debt securities issued by corporations and other entities. Due to a massive debit position in HDAT transactions, the Committee of Primary Dealers Supervision and Control decided as of 8 April (and until further notice) automatically to proceed to repo auctions, at the end of HDAT trading day, in order to cover all transactions with such debit positions.

This change has caused significant concerns for market participants and active discussions with the Greek authorities, being led by the European Primary Dealers Association (EPDA). Representatives of the ERC have been closely involved in the discussions and continue to actively support the EPDA's efforts.

Also responsive to concerns over euro area government securities financing, on 10 May the ECB announced new decisions on "measures to address severe tensions in financial markets" – including the possibility to purchase government bonds.

European triparty interoperability: The ERC Committee is aware of the considerable amount of work that has already been done over the last couple of years on the development of a European triparty interoperability model. Both ICSDs have confirmed their continuous interest and support for triparty interoperability between them, thereby allowing growth of the GC basket trading activity. At its most recent meeting in Berlin the ERC Committee once again reviewed this topic with the ICSDs. The ERC Committee gave due consideration to its prior discussions; the deliberations under the auspices of COGESI (in particular at its *ad-hoc* meeting in Frankfurt on 14 December 2009); and the feedback from a recent debate during a meeting of the ERC Operations Group. In summary, the ERC Committee has now agreed upon a model as the current way forward for enhanced trading in triparty repo (through baskets of equal collateral) via one CCP, with settlement neutrality – based upon the willingness from both ICSDs to create interoperability in collateral transfers. The ERC Committee believes this market-led solution will be crucial for future product developments in Europe as it effectively bypasses the interoperability issue of CCPs. An alternative model offering access to Eurex Clearing for GC Pooling is not to be currently pursued, because of connectivity problems that for the time being cannot be overcome.

US triparty: On 17 May, the Federal Reserve Bank of New York announced the publication of a White Paper on the work of the Triparty Repurchase Agreement (Repo) Infrastructure Reform Task Force. The White Paper highlights policy concerns over weaknesses in the infrastructure of the triparty repo market and seeks public comment on the task force's recommendations to address these concerns. The recommendations set out by the Task Force in its final report, when implemented, should:

- dampen the potential for problems at one firm to spill over to others;
- clarify the credit and liquidity risks borne by market participants; and
- better equip them to manage these risks appropriately.

Based on its analysis, the Task Force identified the following areas where improvements are needed: operational arrangements; dealer liquidity risk management; margining practices; contingency planning; and transparency.

The detailed recommendations contained in the main body of the report address all of these areas.

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Investors' view of covered bonds

On 7 May 2009, the Governing Council of the ECB agreed on the Covered Bond Purchase Programme (CBPP), the technical modalities of which were published on 4 June 2009. The purchase of covered bonds started in July 2009. The aim of the programme was "to support a specific financial market segment that is important for the funding of banks and that had been particularly affected by the financial crisis". On 30 June 2010, as expected, the CBPP had indeed been fully implemented and as announced by the ECB the nominal amount of €60 billion had been purchased on the primary and secondary markets. The Eurosystem said that it intended to keep the purchased covered bonds until maturity.

The ICMA Covered Bond Investor Council (CBIC) has been in existence for more than a year now. Covered bond issuers and traders have their own organisations to represent their views. It was felt that investors too needed to ensure that their views are made known and their interests protected at an early stage in every industry discussion. The CBIC aims at promoting the quality of the covered bond product and representing the interests of investors in European covered bonds. The CBIC promotes simplicity and transparency. The CBIC strongly believes it is of vital importance to improve transparency, with the objective of making it easier for investors to compare different covered bond programmes.

The Chairman of the Council, Claus Nielsen (CTN) from Norges Bank, explains to Nathalie Aubry-Stacey (NOAS), Secretary of the CBIC, the covered bond market and its importance for the capital market.

NOAS: Claus, can you explain what a covered bond is?

CTN: One of the main obstacles to further expanding the investor base for covered bonds is the current fragmented nature of the market. For the time being there is no common agreed definition. The covered bond is understood to be a high quality product but is not a protected trademark and as such can be misjudged. The European Covered Bond Council (ECBC), has identified some essential features and we have European legislation/directives defining covered bonds. The ECBC is currently working on the possibility of introducing a label defining covered bonds which I think would be the first important step to ring fence the product and to introduce more clarity.

With the risk of becoming too simplistic, a covered bond is a debt instrument issued by a financial institution secured by a ring-fenced cover pool of mortgage loans (property as collateral) or public-sector debt to which investors have a preferential claim in the event of default. While the nature of this preferential claim, as well as other safety features (asset eligibility and coverage, bankruptcy-remoteness and regulation), depends on the specific framework under which a covered bond is issued, it is the safety aspect that is common to all covered bonds. Covered bonds are therefore relatively unique: an investor has recourse to the issuing bank, but if a bank is insolvent payments should continue to be made on the bond through to maturity from the collateral pool securing the bond. Luckily, or unluckily, we have, as far as I know, never seen how this would work in reality.

It is interesting to note that there are in fact two types of covered bonds—those covered bonds that are subject to relevant national legislation, and also covered bonds that are not subject to national legislation, which are called "structured covered bonds." The latest developments in Europe have brought more covered bond programmes under national legislation, a development which I welcome.

NOAS: What is the role of covered bonds in the financial system?

CTN: Traditional covered bonds are over 200 years old and are a major long-term funding tool for financial institutions in Germany (called Pfandbriefe), France (Obligations Foncières), Spain (Cédulas Hipotecarias), Sweden and Denmark. The importance of covered bonds for bank financing has been growing vis-à-vis unsecured funding but also lately outside these above-mentioned countries. The issuance of covered bonds enables credit institutions to obtain lower cost of funding in order to grant mortgage loans for housing and non-residential property as well as, in certain countries, to finance public debt. The portfolio investor has the advantage of investing in high quality bonds with a relatively high return. A well functioning covered bond market is seen as essential for a solution to the current crisis.

Since 2008, a new type of investor with a credit investment mandate has become a more visible force in the market, seeing this product as offering an attractive combination of yield and security compared to other credit instruments.

NOAS: The CBIC represents investors' interests in the European covered bond market. What is the European landscape of the covered bond market?

CTN: The internationalisation of formerly domestic covered bond markets began 10 years ago and many European countries introduced new covered bond legislation or updated existing rules to be a part of this development and also respond to the considerable growth of mortgage lending activities in the EU. Each different country's covered bond laws regulate what assets are eligible to back covered bonds, the minimum quality requirements for the assets, and how investors will be protected if the issuing bank goes bankrupt. The legislation therefore stipulates how the collateral framework must operate. The European market is fragmented, and it is difficult for investors to compare products. Working on greater harmonisation where possible, as well as setting minimum standards and simplicity, is key for the CBIC.

NOAS: One of the main issues looked at by the CBIC is transparency of the product: what is the CBIC view on this?

CTN: The CBIC created a Transparency Working Group from the outset, highlighting the importance of this issue for investors. The Working Group produced a paper where the Group laid out a set of minimum requirements for covered bond transparency. The five points made as regards data needed were: (1) general issuer data (eg status of issuers, ratings); (2) collateral quality (public cover pool; mortgage cover pool; and general information); (3) the legal framework/structure; (4) reporting; and (5) pricing/secondary market issues. The views have been discussed with the ECB.

Hopefully, the ECBC will be able to implement the covered bond labelling and as part of this project there should be a commitment to be transparent. A first step could be that issuers agree upon a common template at national level. This has already happened in some countries like Germany and Sweden. Currently, looking at the landscape of European issuers and the degree of cover pool transparency, the difference between the best and worst is massive. Rating agencies will continue to play a major role but any independent quality assessment from the investor side requires easy access to relevant information.

NOAS: Would that improve liquidity in the market?

CTN: Again a Working Group had been set up from the start. I feel that the CBIC needs a long-term view on this issue and no easily found solution is in sight. Attempts to reintroduce the old market maker commitment for jumbo covered bonds albeit in a much weaker form have so far not succeeded. Banks for obvious reasons do not have the same balance sheet commitment as before the crisis and it is very unlikely that this will change. Fundamental questions about the current market structure have to be raised not only for the covered bond markets but for other part of the fixed income market as well. This is a difficult issue as well for investors.

Regarding mandatory post-trade transparency, reading between the lines this is going to happen. It is a pity the different covered bond market actors could not agree on the introduction of a voluntary covered bond solution. They will now have to adapt to a mandatory solution. My own view is that post-trade transparency is as a positive step for the covered bond market but it should be well balanced.

NOAS: What are the next steps for the CBIC?

CTN: The CBIC has been recognised by regulators as the voice for investors. A delegation from the CBIC visited the ECB on 6 July to participate in further discussions. We would like to take the Council further and actively engage investors with an interest in covered bonds in our work, and be more active in the regulatory space. As investors we of course have very different views about investment decisions, but this market will continue to develop and it is essential that investors, as a group, participate in discussion on the future development of the market structure.

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Corporate governance

Measures to strengthen control and risk management in institutions, directors' liability and increased shareholder engagement are the corner stone within Commissioner Barnier's *Green Paper on Strengthening Corporate Governance in Financial Institutions*. The Green Paper, which is open for consultation until 1 September, also provides broader reflections on corporate governance in listed companies and corporate social responsibility. The governance reform plan is part of the Commission's roadmap to meet commitments made at various G20 meetings to strengthen transparency, responsibility and capital requirements. The ICMA Asset Management and Investors Council (AMIC) intends to respond to the Green Paper.

The European Commission mentions that the financial crisis has revealed noticeable weaknesses in the corporate governance of financial institutions and suggests that timely and effective checks and balances in the governance systems would have helped mitigate some of the risks. The Green Paper explains clearly that the Commission supports the view that, heretofore, shareholders did not exercise control over risk-taking in financial institutions they owned.

Currently, European corporate governance is a mix of existing rules, mainly relating to mergers and acquisitions and shareholders' rights, alongside recommendations on the inclusion of independent directors and directors' activities and remuneration policies. The Green Paper is an early stage policy document which is seeking to bring together governance policy at the EU level to "ensure that the interest of consumers and other stakeholders are better taken into account, businesses are managed in a more sustainable way and bankruptcy risks are reduced in the longer term". Further proposals are expected from the Commission in the autumn.

AMIC members met Commission officials on 23 June to discuss some of the points made in the Green Paper. They explained that the asset management industry should be clearly differentiated from the banking industry in the current regulatory debate. Asset managers are responsible for assets under management, for which they act as fiduciary agents. In the context of corporate governance, asset managers are not the ultimate owners of the assets. Any regulation trying to regulate the agents as a proxy for encouraging desired behaviour by principals may be counterproductive, as agents can only act on behalf of their clients, and if principals decline to empower agents – or go further and positively instruct them not to act – then agents have no authority to follow regulators' instructions to do otherwise.

In the case of remuneration policies, the distinction between the banking and asset management industries should be clear. The way asset managers are compensated is aligned to clients' interests and their time horizons: asset management is a multi-year business rather than a transactional business and remuneration already reflects this, with variable pay based on multi-year performance rather than a one-year record of transaction-driven profits. As a result the timeline on which an asset manager's performance is evaluated is much longer than one year and is more likely to be based on 2-3 years. The aim for asset managers is to achieve repeat business and this is done by proving performance over time.

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AIFM Directive: latest developments

Members of the European Parliament's Economic and Monetary Affairs Committee (ECON) voted in favour of the Parliamentary version of the EU's AIFM Directive on 17 May. The following day, EU Finance Ministers at the ECOFIN agreed to give the EU Presidency the mandate to negotiate on behalf of the European Council with Parliament.

The approved ECON report and the text discussed at ECOFIN will serve as the basis for negotiations at the trialogue discussions. Meetings between representatives of ECON, the Presidency of the European Council and the European Commission over the final draft of the Alternative Investment Fund Managers (AIFM) Directive are continuing to agree on a compromise text. The trialogues were originally planned to conclude in time for a vote on the Directive to take place in the European Parliament on 6 July, but they are currently deadlocked and seem likely to continue until September, if not later.

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Private Banking Working Group

As Charles Hamer, Chairman of the ICMA Private Banking Working Group, mentioned in his interview in the last ICMA Newsletter, a Charter of Quality is currently being drafted to explain the functions of the private banking industry. In the Charter, three main themes are highlighted: integrity; transparency; and professionalism. The Charter will also include an overview of the different regulatory requirements imposed upon the private banking industry in one single document. The Working Group is still receiving comments about the Charter and revising it accordingly.

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AMIC: recent and planned events

27-29 May 2010: ICMA AGM in Brussels
John Nugee and Charles Hamer participated in the panel entitled "Issues facing the buy side post crisis".

17 June: ECBDA Roundtable
This Roundtable organised by ECBDA aimed at promoting constructive dialogue between investors and dealers in the covered bond market. Andreas Denger of MEAG, and Daniel Rauch of Union Investment, attended the Roundtable on behalf of the CBIC.

23 June: Meetings in Brussels
Representatives of the AMIC had meetings with: Paulina Dejmek, members of the Cabinet of Commissioner Barnier, and Salvatore Gnoni, of DGMARKT Securities Unit, and officials of DGMARKT Asset Management Unit.

28 June: Private Banking Working Group meeting
The Working Group met in London and discussed the Charter of Quality.

28 June: AMIC dinner with Paul Tucker
The AMIC met in London for a dinner. The guest speaker was Paul Tucker, Deputy Governor of the Bank of England.

29 June: AMIC meeting

6 July: CBIC meeting at the ECB
The ECB organised a meeting with covered bond market participants at the ECB. Participants discussed the main challenges and current market initiatives in the covered bond market.

12 July (tbc): Meeting in Brussels on corporate governance
The European Commission is planning a meeting of a number of investors as a follow-up to a meeting we already held in February this year about shareholder engagement and stewardship. They have been working on these issues in the context of the Green Paper on Corporate Governance in Financial Institutions which the Commission adopted early June. The basis for the meeting will be the Green Paper and a further document which they will circulate ahead of the meeting.

14 July: Meeting with the FRC
The Corporate Governance Working Group will be meeting Peter Montagnon who is in charge at the FRC of implementing the ISC Code on the responsibilities of institutional investors.

Late August: Buy-side associations meeting

Late September: Private Banking Working Group meeting

Late September: AMIC meeting

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Prospectus Directive review

Following compromise agreement in trialogue between the European Commission, Parliament and Council, the Parliament adopted a legislative resolution to amend the Prospectus Directive in plenary session on 17 June, which has now been included in a notification to the Council, with the endorsement that it corresponds to the compromise and ought therefore to be acceptable for adoption as a legislative act by the Council once examined by the relevant legal/linguistic experts.

Once adopted and published in the *Official Journal* (currently anticipated for the autumn), Member States will have 18 months to implement the provisions of the amendments to the Prospectus Directive into their domestic laws.

Notable positive provisions from the Eurobond perspective include:

- better aligning the definition of qualified investors with the Markets in Financial Instruments Directive (MiFID);
- requiring written consent for third party use of the prospectus;
- providing that the summary purpose just be to "aid investors when considering whether to invest", focusing on "key information that investors need in order to be able to decide which offers and admissions of securities to consider further" (the 2,500 word limit is however not changed);
- providing that no civil liability arises from the summary "unless it is misleading, inaccurate or inconsistent, when read together with the other parts of the prospectus, or it does not provide, when read together with the other parts of the prospectus, key information in order to aid investors when considering whether to invest in such securities."
- continuing prospectuses' 12 month validity period;
- providing that the supplement obligation continues until the "later" of final closing of the offer to the public and the time when trading on a regulated market begins.

Other provisions include:

- increasing the €50,000 denomination and consideration exemptions to €100,000 (with a parallel amendment to the Transparency Directive taking effect from the 20th day following the *Official Journal* publication);
- maintaining the sub-€1,000 regime;
- noting that final terms should only contain securities note information that "might for instance include the international securities identification number (ISIN), issue price, maturity, coupon, exercise date, exercise price and redemption price and other terms not known at the time of drawing up the prospectus."

ICMA will be considering any consequent changes to standard market practices and documentation. It will continue to liaise with the European institutions as necessary, in particular in relation to the forthcoming reviews of the Prospectus Directive Regulation, the Market Abuse Directive (with a public consultation running until 23 July) and the MiFID.

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Book building and allocations

As anticipated in the April edition of the ICMA Newsletter, a further informal Roundtable of some investors, lead-managers and also a few issuers was held in June. Following Chatham House rules, the discussion was wide-ranging, with each group of parties seeking to help the others understand its current practices in relation to its operational constraints. Emerging from this and other discussions is a nuanced picture of recent dynamics in the syndicated cross-border institutional bond markets.

With the crisis, it seems that substantial funds and buy-side professionals abandoned their traditional, and then less performing, asset classes and flooded into the bond markets – particularly in the first half of 2009. These markets were not immune from crisis-related sentiment, as the flood of new money was accompanied by substantial confidence and price volatility. This seems to have impacted all parties, with:

- investors feeling that they have insufficient time to familiarise themselves with transactions (including refreshing their knowledge of the issuers concerned) and so to decide what orders to place; that pre-sounded investors might receive preferential allocations effectively restricting the scope of orders placed by others; and that allocation decisions are too slow in terms of interim investor market exposure;
- lead managers feeling that the investor landscape to be much larger and less transparent than previously (with increased order inflation, massive oversubscription rates, new accounts and existing accounts with changed profiles relating to new sub-funds); and

- issuers worried about their perceived ability to tap the markets at affordable pricing levels; and, like investors, about their market exposure once a transaction is announced. In this respect anecdotal feedback seems to suggest that the average number of orders per transaction rose from circa 50-60 around 2006/2007 to circa 400 in 2009, before dropping back to somewhere over 300 earlier this year.

Frequent issuers generally issue off published programme prospectuses, whilst infrequent issuers generally tend to come to market following circulation of "red herring" draft prospectuses, so nearly all the relevant background information should be in the public domain (though it has been queried whether it is technically possible to circulate reminder web links to these on announcement). Further, longstanding investors that have been proactively involved with the markets and the issuers concerned (including through attending periodic or deal-related investor presentations and calls) should have a fairly fresh understanding and a quick reaction when a transaction is announced. Incidentally, such investors, absent any history of inflating orders or '"flipping" new issues, are likely to be favoured on allocation as part of the stable investor base of the issuer. In this respect, there seems to be little additional favour flowing from being pre-sounded (the main advantage there having been supposed to be a more direct say in price formation) – at least some investors seem to consider pre-sounding not worth the related insider restrictions. Conversely, investors placing or increasing their orders late in the day without clear justification may be seen by syndicate desks as doing so because of perceived transaction popularity – so likely being inflators and/or flippers rather than investing on the basis of issuer fundamentals. However, it seems that the managers of certain investor accounts need to comply with certain formalities or confer with colleagues managing sub-funds before placing individual orders.

The process of allocating orders is complex and is a time when both issuers and investors face market risk. Whilst building a book may be swift, reconciliations of the orders placed by the same investors with different lead managers might take a couple of hours (this reduces substantially as shared IT order book solutions are adopted) and, once the cleaned book is available to the issuer and the managers, the final allocation decisions are taken and then communicated to investors.

The ICMA Primary Market Practices Committee will shortly be meeting to consider the outcome of the recent discussions.

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Issuer Forum

The inaugural meeting of the ICMA Issuer Forum was held in London on 28 June. The Forum aims to gather the major financial institution group issuers from amongst ICMA's members to discuss common issues of market practice. Currently, the members are Allied Irish, Anglo Irish Bank, Barclays Capital, BNP Paribas, Citi, Commerzbank, Credit Suisse, Danske, Deutsche Bank, HSBC, ING, Lloyds Banking Group, Morgan Stanley, Nomura, Nordea, Rabobank, Royal Bank of Scotland, RZB Raiffeisen, Santander, SEB, UBS and Unicredit.

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ICMA corporate bond market survey: results

In the last edition of the Newsletter, we reported that ICMA had launched a survey on liquidity and trade transparency in the corporate bond markets. Given the MiFID review and the importance of liquidity and trade transparency, ICMA felt it was important to explore these areas more fully with its membership so that it could put a more complete picture of our members' views before the Commission in a transparent way.

ICMA's survey was sent electronically to all ICMA members, while non-members could also participate via the ICMA website. The survey related solely to the European corporate bond market (both senior debt and subordinated debt). The questions did not ask about ABS, covered bonds, CDOs, CDS or other securitized instruments.

By the closing date of 8 May, we had received 99 responses. When analysing the data, only responses in which the majority of the 24 questions had been answered were included in the data set. Accordingly, our analysis was based on 69 responses, though not all respondents answered every question.

Of the 69 responses, 41% of respondents identified themselves as buy-side; 36% were sell-side; 13% were repo/ securities lending and the remaining 10% consisted of an industry association, issuer, intermediary, bond syndicate and exchanges. Respondents were based in 16 European countries: Belgium, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Norway, Spain, Sweden, Switzerland, the Netherlands and the UK. Additionally, there were respondents from Australia, Brazil, the United Arab Emirates and the US.

From the results of the survey, we can draw the following conclusions. Liquidity is the most important consideration for all market participants when trading (ie ranked the highest). This is closely followed by certainty of execution, evidence of best execution and speed of execution. On the other hand, low market volatility, anonymity, ticket size and post-trade transparency received the lowest rankings. Another significant finding from the data was that respondents were fairly unanimous that electronic trading, greater pre-trade transparency, greater volume transparency and larger issue sizes could all help to improve liquidity. Greater post-trade transparency was not as highly ranked by buy-side, sell-side or repo respondents.

Regarding the calibration of a post-trade publication scheme, respondents favoured:

- scope to include either all corporate bonds or those bonds of a certain issue size;
- high/low/median price data to be published end of day;
- aggregated volume data to be published end of day;
- time delay for large trades of end of next day and the larger the trade the longer the delay to accommodate large/block trades;
- large trades defined either on the basis of trade size over certain thresholds (e.g. €5 million) or trades greater than for example 10% of the issue size.

Finally, it is worth noting that the only question where there was significant divergence of opinion between the buy side and the sell side was: "Do you have concerns about the ability of market participants to execute trades in corporate bonds?" Overwhelmingly, the sell-side answered "no" while the buy-side answered "yes". However for all other questions in the survey, there was a surprisingly significant degree of consensus between the buy side and the sell side.

More detail on the results of the survey can be found on the ICMA website.

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CESR consultation on non-equities transparency

CESR published its Consultation on Non-equity Markets Transparency on 7 May. The consultation paper (CP) examines the merits of greater transparency for a wide range of securities, including corporate bonds, structured finance products (ABS, CDOs and CDS), and a range of derivative instruments such as interest rate derivatives, equity derivatives, commodity derivatives and FOREX derivatives. The main conclusions set out in CESR's July 2009 Report were reiterated – ie that the lack of post-trade transparency was not considered to be a key reason behind the difficulties experienced in the corporate bond market during the financial crisis and that additional post-trade transparency would not be able to solve the different problems as a singular measure. However, in combination with other measures, additional post-trade transparency would contribute to improving market conditions. In summary, the corporate bonds section covers:

Scope: CESR members, in the July report, had disagreed on the scope of the post-trade transparency framework. The main text of the July report defined the scope as corporate bonds for which a prospectus has been published (ie including all corporate bonds admitted to trading on a Regulated Market or MTF). However, a footnote revealed that four CESR members disagreed – Sweden, the UK and Ireland felt the scope should be limited to more liquid bonds while Germany felt that limiting the scope to deal with bonds for which a prospectus had been published and which exceeded a moderate initial issuance size was a practicable liquidity filter. This disagreement was not raised in this latest CP, which instead takes, as a given, that the transparency regime will cover corporate bonds for which a prospectus has been published (ie all corporate bonds admitted to trading on a Regulated Market or MTF). What was raised was the question of whether covered bonds should be treated as corporate bonds or as structured finance products for the purposes of post-trade transparency.

Pre-trade transparency: At the behest of the Commission, the latest CP asked for feedback about whether there is a lack of pre-trade transparency, whether pre-trade information is accessible to all market participants, whether such information is efficiently disseminated, etc.

Post-trade transparency – calibration of framework: CESR reiterated its view that the information to be made public should include a description of the bond, and price/yield, volume and time of trade. The recent CP also asked if there was value in publishing the notional value of the bond.

In addition, CESR reiterated the need for delayed publication of transactions above certain thresholds in order to adequately reflect the risks incurred by the sell-side when committing capital to the market. CESR felt it was difficult to find a single criterion, such as average daily turnover or initial issuance size, which could capture both the volume and frequency of trading in an adequate and consistent manner. Instead, CESR proposed that the thresholds be based solely on the size of the transactions, which could be more indicative than the initial issuance size. CESR proposed the following:

Transaction size (net value)	*Information to be published*	*Timing of publication*
Below €1 million	Price and volume of transaction	As close to real time as possible
Between €1 million and €5 million	Price and volume of transaction	End of day
Above €5 million	Price but no volume (but with an indication that the transaction has exceeded the €5 million threshold)	End of day

For transactions below €1 million, where CESR feels that price and volume should be published "as close to real time as possible", it accepted that trading in corporate bonds is less automated than for equities and therefore the 3 minute MiFID deadline for equities may not be appropriate for corporate bonds. CESR also noted that the TRACE system in the US accepts a 15 minute delay. Respondents were asked whether they agree with CESR's proposed calibration, whether other criteria should be considered for establishing thresholds and what delay is suitable for defining "as close to real time as possible".

ICMA responded to the CESR consultation by the deadline of 4 June. The ICMA response drew heavily on the data analysis of the ICMA Bond Market Survey.

CESR has now published the 40 non-confidential responses it received as part of the consultation.

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Short selling

On 14 June, the European Commission published a Consultation Paper (CP) and FAQs on short selling. Short selling is defined as "the sale of a security that the seller does not own, with the intention of buying back an identical security at a later point in time in order to deliver the security." The CP distinguishes "covered" short selling (where a seller has borrowed the securities or made arrangements to ensure they can be borrowed before the short sale) from "uncovered" or "naked" short selling (where a seller has not borrowed the securities at the time of the short sale or ensured that they can be borrowed).

The CP sets out two options regarding the proposed scope of the regime. Option A would apply rules uniformly to all types of financial instrument admitted to trading in the EU on a trading venue (ie regulated market or MTF) and that can be the subject of short selling. Option B would apply different rules to different asset classes. For example, different rules would apply to different instruments such as: EU shares and derivatives relating to those shares; EU sovereign bonds and derivatives relating to those bonds; and CDS relating to EU sovereign issuers.

The CP sets out proposals in three areas: transparency; uncovered short selling; and emergency powers for Competent Authorities to impose temporary short selling restrictions.

Transparency: The CP uses, as its starting point, the two-tier transparency model for EU shares recommended by CESR in its March 2010 report – ie a notification of a net short position would be made to the regulator if a lower threshold is met; if a higher threshold is met a disclosure would additionally be made to the market. The CP considers two policy options based on the CESR transparency model. Option A would apply the CESR approach to all types of financial instruments that are admitted to trading on a trading venue in the EU. Excluded from this would be instruments which due to their nature cannot be the subject of short selling. Option B would apply the CESR approach to only EU shares and EU sovereign bonds and in respect of significant net short positions of EU sovereign bonds, the regime would be limited to notifications to regulators only – ie there would be no disclosures to the market, though the CP asks for views. The calculation of a net short position in relation to sovereign bonds should take into account CDS if those CDS relate to the sovereign bond in question. The CP suggests thresholds for short positions in shares, but is silent in relation to thresholds for sovereign bonds, except to say that in calculating the thresholds, the total face value of the outstanding EU sovereign bond and the average size of positions held by market participants in that sovereign bond would be considered.

The CP proposes that the notification/disclosure (whether to regulators or to the market) would include details of the identity of the person with the net short position, size of position, issuer in relation to which the net short position is held and date on which the net short position was created, changed or ceased to be held. Notification to the regulator would be made in accordance with existing transaction reporting methods under MiFID. Notably, the Commission sets out that disclosures to the market would be made "available to the officially appointed mechanism of the home Member States of the issuer of the shares". How this would work, if Option A were adopted, is unclear. The CP also sets out that the net short positions would be calculated at midnight at the end of the trading day and the notification to regulators or disclosure to the market would need to be made by 3.30pm on the next trading day.

Uncovered short sales: The CP notes that uncovered or naked short sales is a term usually related to shares. However, as national decisions have recently been taken regarding sovereign bonds the CP asks for feedback on the risks of: (a) naked short selling; and (b) naked short selling of financial instruments other than shares (eg bonds or sovereign bonds). Nevertheless, the CP proposes a rule whereby a person would not be allowed to enter into a short sale of any share admitted to trading on a trading venue unless the position is covered. The CP asks whether there should be permanent limitations or a ban on entering into naked CDS relating to EU sovereign issuers.

A buy-in rule is also proposed for trading venues and/or CCP/settlement systems that provide clearing/settlement for trading venues. Thus, if a person who enters into a short sale of shares is unable to deliver the shares for settlement within a specified time the buy-in rule would be triggered to buy in the shares for settlement.

Exemptions: The CP proposes a market-making exemption consistent with the recommendation in CESR's March report, so that where firms, in the particular circumstances of each transaction, are genuinely acting as market maker they would be exempt from making both private and public disclosures. A market maker is defined as an investment firm that is a member of a regulated market or an MTF, that deals as principal in the relevant share and/or related derivatives (whether OTC or exchange-traded), in either or both of the following capacities: (a) by posting firm, simultaneous two-way quotations of comparable size and at competitive prices, with the result of providing liquidity on a regular and ongoing basis to the market; (b) as part of its usual business, to fulfil orders initiated by clients or in response to clients' requests to trade, and to hedge positions arising out of those dealings. The CP also suggests that the exemption could extend to the rules regarding naked short sales and buy-in rules.

Emergency powers of Competent Authorities: The CP proposes that, in the case of a serious threat to financial stability or market confidence in a Member State or the EU, a Competent Authority of a Member State could prohibit or impose conditions relating to persons entering into: (a) a short sale of a share or bond admitted to trading on a trading venue for which the Member State is the Home Member State; or (b) a transaction which creates, or relates to, another financial instrument with the effect of conferring a financial advantage on the person in the event of a decrease in the price or value of a share or bond admitted to trading on a trading venue in the Home Member State. Additionally, a Competent Authority could prohibit or restrict the "purposes" for which persons may enter into CDS transactions relating to the default of an EU Member State or the EU or restrict the value of such transactions that may be entered into. Restrictions would be for a period not exceeding 3 months, though restrictions could be renewed.

ESMA would seek to ensure a consistent approach among Competent Authorities. 24 hours in advance of imposing or renewing any measure under this section, a Competent Authority would notify ESMA and the other Competent Authorities of its proposal. Exceptions would be allowed regarding timing of the notification. After receiving a notification, ESMA could advise the Competent Authority on whether the conditions for taking action are satisfied and whether the measures are appropriate. If a Competent Authority proposed to take action contrary to ESMA's advice, it would have to publish a notice fully explaining its reasons for doing so.

The closing date for responses to this four-week consultation is 10 July.

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OTC (derivatives) regulatory developments

In two Communications – dated 3 July 2009 (COM(2009)332 final) and 20 October 2009 (COM(2009)563 final) – the European Commission gave its views on future policy actions to ensure efficient, safe and sound derivative markets. Essentially, the Commission is proposing four policy action areas:

- further standardisation of derivative contracts;
- the use of trade repositories;
- greater use of central counterparty clearing houses (CCPs); and
- greater use of organised trading venues.

The Commission makes reference to a general paradigm shift in what has been its financial market policy to date. It is seeking to break with the traditional view that derivatives require no more than light-touch regulation because they are used by experts, and to propose legislation which, in particular, will increase transparency and enable market participants to price risks properly. As a result, the proposed measures will shift derivative markets from OTC bilateral clearing and trading to more centralised clearing and trading. In December, the Council published its broadly supportive conclusions on the Commission's Communication.

The European Parliament has now made its voice heard on the subject. Its Committee on Economic and Monetary Affairs (ECON) agreed the report of rapporteur Werner Langen, which was subsequently adopted by the Parliament during its 15 June plenary. Its subsequent press release calls for more daylight and stricter rules for the derivatives market. In the rapporteur's view, particular attention should be paid to the following points:

- in future, the prices of derivatives must better reflect risk and the cost of the future market infrastructure must be borne by market participants alone and not by taxpayers;
- CCPs and their risk management systems must not be financed by users and should not compete on risk;
- reporting standards must be laid down for all derivatives so as to ensure that they are communicated to central trade repositories;
- in particular for SMEs, exemptions and lower capital requirements must be allowed for bilateral derivatives;

- CDS derivatives must be subject to independent central clearing; and if necessary, where cumulative risks are involved, it must be possible to restrict them or, on a case-by-case basis, prohibit them;
- national regulatory authorities must be given access to trade repositories; and
- responsibility for authorising CCPs in the EU and third states should be given to ESMA.

To optimise cooperation between national regulatory authorities and ESMA, gradual action is required.

To help develop its thinking, on 27 April ECON conducted a public hearing on OTC/derivatives. Amongst the main issues raised as concerns were exemptions for end-users; CCP locations and interoperability; and trade repository information/transparency.

In order to advance the applicable policy actions, the Commission has made clear its intention to bring forward legislative proposals this year, which will include:

- a cross-cutting European Market Infrastructure Regulation (EMIR) – to create a framework for the authorisation and operation of clearing houses and trade repositories;
- further amendments to the Capital Requirements Directives (CRD) – to create incentives for the use of centrally cleared contracts;
- revision of the Market Abuse Directive (MAD) – to fully cover derivatives; and
- revisions to the Markets in Financial Instruments Directive (MiFID) – to introduce other desired elements, eg OTC transparency requirements.

There is more on these elements of the Commission's work elsewhere in this Newsletter.

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Commission Expert Group on Market Infrastructures

The European Commission services intend to set up an Expert Group on Market Infrastructures (EGMI). The mission of this new group will be to contribute to the development of an efficient, safe and sound European post-trade market. This will be done by giving advice to the Commission services on various issues in relation to post-trade services and market infrastructures in the EU. This group will bring together high-level experts in post-trade issues with proven and recent experience. Dated 7 June, the Commission therefore issued a call for expressions of interest, with a view to listing candidates to be appointed to the group for a 2-year term.

This development in the Commission's liaison with the post-trade market ties in with previously reported discussions at the most recent meetings of the "CESAME2" Group and the Monitoring Group of the Clearing and Settlement Code of Conduct ("MOG").

European Market Infrastructure Regulation

For some time the Commission has been working to develop a proposal for European Market Infrastructure Legislation (EMIL). Having decided that this legislation should come in the form of a Regulation rather than a Directive, EMIL has recently become known as EMIR. Dated 14 June, the Commission launched a Public Consultation on Derivatives and Market Infrastructures. Responses are sought by 10 July, to inform preparation of a formal Commission EMIR proposal, which is currently scheduled for adoption in September.

The main issues now being consulted on are:

- *central clearing requirements:* all eligible derivative contracts should be cleared through a CCP. A process needs to be developed for the determination of the eligibility of contracts. There are also questions relating to the scope of exemptions for non-financial corporate end-users;
- *requirements on CCPs:* the consultation asks what rules are necessary to ensure that CCPs contain risk in the market instead of becoming a potential source of risk concentration themselves;
- *relationship with third countries:* the consultation asks how to ensure that CCPs and trade repositories in third countries can continue to provide services in the EU and what is the right approach for a sector, which is by nature a global one;
- *interoperability:* the consultation asks how best to achieve interoperability between CCPs; and
- *requirements on trade repositories:* the consultation asks amongst other things how to ensure access to data and make sure that trade repositories are adequately organised to receive, process and store that data. And the consultation asks about reporting requirements for market participants to trade repositories.

The development of legislative proposals relating to interoperability will impact the Code of Conduct on clearing and settlement and the related work of the Monitoring Group (MOG).

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Securities Law Directive

The Commission is preparing a proposal for a Securities Law Directive (SLD), including through a series of meetings with a Member States Experts Working Group. This builds on the Commission's summary of responses to its 2009 consultation (ICMA contributed a short high level letter of comment to that process). The timetable for this work has moved back a little, with the Commission now anticipating issuance of its proposals in early autumn.

The SLD will deal with legal certainty of securities holding and disposition, building on the conclusion of the Geneva Securities Convention last year. It is also anticipated that the SLD will include provisions for a more formal legal framework for the carrying on of settlement activities in the EU (as this is not encompassed by the EMIR proposal). A second public consultation is planned to take place later in the summer, requesting stakeholders' views on a set of detailed legal rules, whereas the 2009 consultation was held on the basis of principles.

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ECB Contact Group on Euro Securities Infrastructures (COGESI)

COGESI addresses issues and developments which are relevant for the euro securities settlement industry and which are of common interest for the Eurosystem, market infrastructures and market participants. This includes developments in the field of collateral management and liquidity management, infrastructural developments, issues related to regulation, standards and legal framework, and post-trading activities in general. In Frankfurt on 4 May there was the latest bi-annual meeting of COGESI – the agenda covered:

- triparty collateral management services;
- interoperability between ICSDs;
- interoperability between CCPs;
- trade repositories for OTC derivatives – the Iberclear project;
- CSDs' settlement fails; and
- review of the CPSS-IOSCO standards.

The next regular COGESI meeting is scheduled for 22 November.

Separately, on 19 April the ECB published a *Report on the Lessons Learned* from the Financial Crisis with regard to the functioning of European financial market infrastructures. This identifies procedures and rules that might be enhanced, so that financial market infrastructures, their participants and relevant public authorities are better equipped in future to cope with the sort of events faced during the financial crisis.

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ECB Money Market Contact Group (MMCG)

The MMCG discusses issues related to the euro money market. This includes short-term developments but also structural developments and the functioning of the euro area money market in general. The most recent meeting of the MMCG was held in Frankfurt on 18 May. The agenda covered:

- review of the latest market developments: an ECB led review of the main developments in the euro money market since the last meeting (10 February), followed by discussion; and
- the Basel Committee's proposal for an international liquidity risk framework: an ECB led summary of the main feedback messages received in the public consultation and an overview of the way forward.

The next regular MMCG meeting is scheduled for 8 September.

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TARGET2-Securities (T2S)

As discussed in previous ICMA Newsletters, T2S will be a single technical platform which will allow central securities depositories (CSDs) and national central banks to provide borderless and neutral securities settlement services in central bank money in Europe. In late April, a new issue of T2S OnLine was published by the ECB. In brief, this provides the following status update:

- *T2S Guideline:* On 21 April, the Governing Council adopted the T2S Guideline. The Guideline is the cornerstone of the legal framework for T2S and the basis for all other legal agreements to come in place in the future. The Guideline is binding for the Eurosystem national central banks, but does not create obligations on third parties.
- *T2S timeline:* The T2S Programme Board and the Governing Council have carefully reviewed the T2S project plan. According to the new plan, CSDs will have the opportunity to start testing the T2S software in January 2014, and T2S will be ready to go live in September 2014.
- *External governance:* In exploring different options for the future governance of T2S, consideration was given to the question of whether it would be advisable to structure T2S as a separate legal entity (SLE) during the operational phase. During discussion it emerged that market participants were prepared to accept a continuation of the current arrangement without establishing an SLE if the proper and transparent involvement of stakeholders was ensured. In light of this the T2S Programme Board will focus its governance discussions with the market on a suitable adaptation of the current arrangement.
- *Internal governance:* The Governing Council decided to adapt the mandate and the rules of procedure of the T2S Programme Board, in particular in order to specify the roles and responsibilities of the T2S Programme Board in relation to T2S financial issues.
- *Network issues:* The Governing Council has decided that connectivity to T2S should be provided by competing network providers, who will obtain a licence to carry messages between T2S and the CSDs (and other actors). The Governing Council has also decided to limit the number of providers to three. The Eurosystem will conduct a public consultation this summer on the selection criteria and will launch in the autumn the formal selection process.
- *Framework agreement:* this is one of the cornerstones of the T2S legal architecture and will formalise and regulate the relationship between the Eurosystem and the CSDs. The T2S Programme Board intends to finalise it by summer 2010 and thereafter to offer EU regulators the chance to comment on it. The Eurosystem and the participating CSDs are expected to sign this agreement in the second quarter of 2011.
- *Currency participation agreement:* this agreement between the Eurosystem and the non-euro area central banks stipulates the rights and obligations of both parties regarding the settlement of currencies other than the euro in T2S. It is expected to be ready for signing by the end of this year.

On 22 June, KELER, the Hungarian central securities depository (CSD), signed the T2S Memorandum of Understanding (MoU) with the Eurosystem. In doing so, it joined the 29 other CSDs in 27 countries who had previously signed the MoU, formally confirming their strong support for T2S.

The Advisory Group (AG), which is an advisory body that reports directly to the ECB's decision-making bodies on the T2S project, last met on 1-2 June in Vienna (and next meets in Brussels on 7-8 September) for its latest progress review; and the last meeting of the Programme Board was held on 17-18 December. Other recent important dates have been a workshop on "Schedule of the T2S Settlement Day" – 21 June; a T2S Info Session in Copenhagen – 24 June; and the T2S funds workshop in Frankfurt – 30 June.

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Personal view: How many settlement days do you need? By David O. Clark

In their joint letter of 8 June to the President of the European Commission, President Sarkozy and Chancellor Merkel requested that "the European Commission should also consider the possibility of European harmonisation of the time allowed for securities settlement and delivery relating to trading on European markets." The letter was otherwise devoted to the subject of short selling and sovereign CDS giving the impression that longer settlement periods were seen as a device to sell sovereign debt short. At the same time a requirement to reduce the settlement period to T+1 was passed by the French Assembly, though further legislative approval would be required before such a measure could be implemented.

As no doubt the drafters of the letter and promoters of the French legislation were aware, "National Differences in Settlement Periods" constitute Giovannini Barrier No. 6 – an issue being examined by the "Harmonisation of the Settlement Cycle Working Group" chaired by Paul Bodart of the Bank of New York Mellon and mandated by CESAME2. This was the subject of an "Info-letter on Post Trading" from the European Commission, DG Internal Markets[1]. The looming arrival of T2S of course lends some importance to the issue.

In essence this group is looking to establish conditions and methods to bring the maximum settlement period down to T+2 while permitting settlement on T+0 and T+1 as well. It should also be noted that while the working group is mostly concerned with equity trades its scope also covers the bond markets.

In the early 1990s, the standard settlement period for Eurobond trades was reduced from seven calendar days to three working days. A similar move was made in the US for non-Treasury trades. Since that time the use of physical bonds has all but disappeared and there have been significant improvements in trade confirmation, matching and settlement systems. In addition the failure of Lehman's has highlighted the risk from unsettled trades. It is not surprising therefore that the question, not just of harmonisation, but also of whether to further curtail the standard settlement period has been raised even if the rationale, in some quarters, might be questionable.

Industry reaction to the French proposal to limit settlement to T+1 is understandable for multiple reasons. The trading and post-trading of French securities often involves international firms that are not subject to the French regulatory regime. The issue is not purely about system performance as some transactions already settle at T+0 or T+1 in France (financing operations, securities lending, primary market). Complexities arise when interconnecting multiple systems spread around the globe, working under different technical standards and different time zones.

Today, 50% of turnover in domestic bonds at Euroclear France settle on the same day considering repos and issuance of CDs. Standard gilt settlement is 1 day and up till 13.30 trades can be concluded for cash (same day). Fedwire settlement is normally T+1.

Where T+1 would create real problems would be smaller portfolio managers who claim that systems costs of moving to T+1 would be prohibitive. It would be unfortunate if any such move led to a fall in the number of smaller specialist fund managers. The Bodart Group is adding buy-side members but it is important that views of smaller buy-side firms be taken into account.

Another area of concern is liquidity. Eurobond issues are rarely liquid and market makers may prove less willing to make offers on bonds if they have less time to find the paper in the market.

Against this T+2 settlement would synchronise with the two-day offset period for most LIBOR/EURIBOR rate settings and the two day settlement period for foreign exchange and other derivative transactions thus making packaging of securities simpler and more transparent. Given the plethora of settlement periods that exist today I do not see that this need necessarily be accompanied by a similar move in other markets, though the repo market would need to move from financing at T+2 to T+1.

In conclusion I would welcome a reduction in the standard settlement period for Eurobond trading to T+2 without necessarily making this a maximum. The real benefit will come when we can move seamlessly from one settlement system to another within Europe and possibly globally.

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1 More detailed information on the workings of CESAME2 can be found on the European Commission's website

Cooperation in Chinese financial market

Martin Scheck and Mr. Shi Wenchao, Secretary General of NAFMII at the signing of the MoU

ICMA has recently signed an agreement with the Chinese National Association of Financial Market Institutional Investors (NAFMII) which cements the commitment of the two associations to collaborate on the development of standards for capital markets. The Memorandum of Understanding will lead to closer co-operation and sharing of expertise between the two organisations in harmonising market practice for their respective members who are participants in the capital market.

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ICMA Regional Committees

ICMA looks to its 12 Regional Committees for input to its work programme, events and training. Martin Lee-Warner, who chaired the Committee of Regional Representatives which co-ordinates the activities of the regions, has now handed over the chairmanship to Tim Skeet, Bank of America Merrill Lynch.

Gilles Lindental, Head of Credit at Louis Capital Markets, has become the Chairman of the France and Monaco Region, while Claudia Segre, Head of Fixed Income at ABAX joins the Regional Committee for Italy and Ueli Goldener, Head of Fixed Income Sales at SIX, and Beat Gabathuler, Managing Director at Zürcher Kantonalbank, join the Regional Committee for Switzerland and Liechtenstein. We have a vacancy for a regional chair for the Nordic Region. Interested individuals from ICMA member firms are invited to get in touch.

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allan.malvar@icmagroup.org

ICMA AGM and Conference 2011 – save the date

Over 600 ICMA members and guests attended our recent 2010 AGM in Brussels in May to hear debates on the state of regulation in Europe. Preparations are already under way for the 2011 meeting which will be held in Paris from 25 to 27 May so please save the date in your calendar.

Contact: events@icmagroup.org

ICMA events in the autumn

New workshop on the ICMA Primary Market Handbook

In response to recent increased demand from members for guidance on the use of some of our core resources, we are introducing a new workshop on ICMA's Primary Market Handbook for the issuance of international debt and debt related instruments. The half-day session will give an overview of the scope and application of the recommendations and will also review recent developments and changes. The first course will run in London in September.

- Understanding the ICMA Primary Market Handbook, 22 September, London

MiFID review – seminars in Europe

A series of seminars on the MiFID Review, which will cover developments affecting transparency and liquidity in the OTC markets and on exchanges, for both cash and derivatives markets will be run in major European financial centres, featuring speakers from ICMA, ISDA, the markets and regulatory authorities.

The first of these seminars, which are open to members and non-members of ICMA, will take place on 28 September in Zurich - in association with SIX, and on 30 September in Luxembourg - in association with the European Investment Bank.

For further details on all the events listed above contact: events@icmagroup.org

ICMA Executive Education

ICMA Executive Education has successfully partnered with the Egyptian Banking Institute (EBI) to run its first certificate programme in Egypt. The Financial Markets Foundation Course was run in the offices of EBI from 20-22 June with ten candidates from banks in Cairo. Eight of the participants successfully achieved the certificate and their names are listed on our website. We are now undertaking a broader strategic review of courses and objectives with EBI to see if we can expand our offering of courses with them in Egypt in future.

The International Fixed Income & Derivatives (IFID) Certificate, the benchmark qualification for fixed income practitioners has been awarded to 126 graduating MSC students at the ICMA Centre, University of Reading, where the IFID programme forms a part of the course. A total of 160 students from around the world have been awarded the IFID Certificate so far in 2010.

The next IFID residential course will be taking place in Asia. This is the first time ICMA will run the residential programme in South Korea. Hosted by the Korea Financial Investment Association (KOFIA), the recognised IFID benchmark qualification for fixed income practitioners will be taking place on Jeju Island, South Korea on the 22-28 August 2010.

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Summary of forthcoming ICMA Executive Education courses

Introductory programmes

Financial Markets Foundation Course (FMFC)
20-22 September, London
27-29 September, Luxembourg

Securities Operations Foundation Course (SOFC)
12-14 October, London

Intermediate programmes

International Fixed Income and Derivatives (IFID) Certificate Programme
Next residential course:
22-28 August, Jeju island, South Korea
24-30 October, Sitges, Barcelona

Operations Certificate Programme (OCP)
27 March-2 April 2011, Brussels

Specialist programmes

Primary Market Certificate (PMC) London
15-19 November, London

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.

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