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## Message from the new ICMA Chairman

*Foreword by Cyrus Ardalan, Chairman of ICMA*

The financial markets represented by ICMA's members continue to face unprecedented challenges and scrutiny. Fortunately this is happening at a time when ICMA is better positioned to address these challenges than at any other time in its past. Today ICMA is a very focused, dynamic and professional representative body with a broad base of members. ICMA's importance and the value its members place on its activities was particularly evident in the success of its recent AGM in Paris attended by over 700 people. It is therefore a great privilege for me to be appointed by the Board as ICMA's Chairman at this time.

ICMA's establishment and recognition as the leading international trade association was achieved under the stewardship of my predecessor Hans Joerg Rudloff. During his six year term as Chairman he oversaw the radical overhaul of the Association, its finances, governance and structure. It was his vision to refocus the Association firmly on the "mechanics" of the international debt capital markets with the goal of making markets as efficient, professional and robust as possible. This vision led to the successful sale of ICMA's remaining commercial services, leaving the Association free to expand its core activities in setting standards of best market practice and representing all its members in their interaction with regulators and policy makers. Judicious investment in the regulatory policy aspects of ICMA's role have transformed the Association into a trade body with which both EU and global regulators must engage.

In addition to our traditional base of banks and brokers on the sell side, we have stepped up representation of issuers on the sell side and also of the buy side of the industry, dealing with matters concerning both wholesale and retail markets. Moreover through expanding outside Europe ICMA has extended its cooperation with other like-minded trade associations in India, China, Russia and Brazil amongst others. This has now become one of our core strengths. ICMA provides a forum where all capital market constituencies can meet to discuss evolving market practices, agree on standards and respond to regulators on behalf of the market.



Cyrus Ardalan

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A central part of the ICMA mission has been a commitment to education. This has been reinforced by the renewal of the arrangement with the ICMA Centre at the University of Reading. The offering of Executive Education programmes has grown and flourished even in the harshest market conditions. We see great opportunities for continuing to expand this area of activity.

ICMA has embarked upon a number of key initiatives in 2011, notably in sovereign debt, covered bonds and the repo market. A consistent theme throughout has been the bringing together of market participants to agree and to put in place standards of transparency and clarity in specific market sectors. These will ultimately benefit the market by creating efficiencies for all participants – from issuers to investors. An energetic and fully engaged membership has been an essential prerequisite of this work and I have been impressed in recent weeks as I have discovered the level of voluntary involvement by our members in our work.

In conclusion I am determined that, with the support of the ICMA Board, members and staff, we can continue to build on the success of the Association in the development and maintenance of best market practice standards. I am very pleased to be chairing the Board of the Association at such an exciting time in its 43 year history. I firmly believe that ICMA now has both the leadership and the standing to make an important contribution to determining the future functioning of the cross-border securities markets of Europe and indeed the wider global markets. The opportunity to bring to bear my personal experience in international debt capital markets, at Barclays Capital and before that at Paribas and the World Bank, on some of the important technical challenges our market is currently facing is one that I value highly.

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**Cyrus Ardalan**  
Chairman, ICMA

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## Message from the Chief Executive



**Martin Scheck**

The highlight for ICMA since the last quarterly assessment has been our AGM and Conference, held in Paris on 25 to 27 May.

The AGM is always important for the membership – this year particularly since the proposal to increase the fees from 1 January 2012 was so crucial to the future of ICMA. Many thanks for the confidence you have shown in ICMA and our activities with your overwhelming vote in favour.

I would also like to welcome the new Board members to ICMA – Allegra Berman from UBS and Spencer Lake from HSBC – and I am delighted that Cyrus Ardalan has also joined the Board and been chosen as Chairman. Cyrus' breadth and depth of experience in the securities markets and his wealth of contacts fit him ideally

for this role and I and my colleagues look forward to working with him. On behalf of all of us at ICMA, I would like here to thank Hans-Joerg Rudloff for his vision, guidance and active support during his tenure as our Chairman over these last six years.

The AGM and Conference were particularly well attended this year, and the comments from the panels and keynote speakers illustrated just how critical it is for the industry to engage actively with the regulators and policy makers to ensure that the views of market practitioners are fully considered. Along with our role in setting standards of best market practice this is one of ICMA's key functions – and we are grateful to those of you who sit on our committees, councils and working groups for your contribution to this process on behalf of the industry as a whole.

**Martin Scheck**  
**Chief Executive, ICMA**  
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The Future of Capital Markets panel at ICMA's Paris AGM and Conference. Left to right: Jean-Marc Giraud, Global Head of Global Capital Markets, Société Générale Corporate & Investment Banking; Jim Turnbull, Managing Director, Triarii Advisors; Martin Scheck, Chief Executive, ICMA; Martin Egan, Global Head of Primary Markets & Origination, BNP Paribas; Lachlan Burn, Partner, Linklaters LLP; Frank Czichowski, Senior Vice President/Treasurer, KfW

## Reforming the international capital market

The debate about how to prevent – or at least reduce the scale of – the next international financial crisis by learning lessons from the last one has raised a number of serious questions, all of which are difficult to resolve. Much of the debate has been about the role of the banks. But it is equally important to focus on the role that the international capital market can play in contributing to a stable and resilient international financial system while promoting the growth of the international economy.

The crisis demonstrated how difficult it is to achieve financial stability without liquid markets. Market liquidity depends on the willingness of dealers to trade, and they in turn depend on demand from investors or financing from banks. Market confidence depends on the quality of financial assets being traded, the robustness of market counterparties and the resilience of the market infrastructure. When market confidence disappears, a liquidity problem in the markets can quickly become a solvency problem for the financial institutions operating in them.

### Crisis prevention

Since the crisis there has consequently been much greater focus on achieving financial stability, not just by regulating and supervising individual financial institutions, but by regulating and supervising the financial markets and the post-trade infrastructure for clearing and settlement underpinning them. The question is how best to increase the stability of the financial system without imposing undue costs that could delay the international economic recovery. The steps which the authorities are taking to prevent another crisis are both structural and cyclical in scope.

*Structural changes* are being made at three levels:

- At the level of *individual financial institutions*, under Basel III, more and better quality capital and liquidity and less leverage will be required, especially in the case of systemically important financial institutions, which have carried an implicit government guarantee because they are “too important to fail”. Although there is a lengthy transition period, many financial institutions are expected to implement the new requirements in advance so as to reassure the market that they have no difficulty in doing so. The new requirements should increase the stability of the financial system, but at a cost in terms of the extra capital and liquidity required.

- At the level of *financial markets*, more transparency will be required (eg as a result of the European Commission’s review of MiFID), though too much transparency makes dealers reluctant to commit capital, with a reduction in market liquidity as a result. In addition, the regulatory perimeter will be extended; and over-reliance on credit rating agencies will gradually be reduced.
- At the level of the *market infrastructure*, clearing through central counterparties (CCPs) is being introduced for standardised OTC derivatives with the objective of making the system more resilient. Dependence on CCPs will reduce the counterparty risk for market firms, but increase the risk of creating new institutions that are “too important to fail”.

As regards *cyclical changes*, central banks have traditionally “lent against the wind” by raising interest rates to tighten monetary policy. But the rise in interest rates was not sufficient to prevent the last crisis. That leaves open the question of whether interest rates should have been raised earlier for longer, or whether other steps should have been taken by the authorities. What other steps can the authorities take to prevent a financial crisis next time? One option is for the authorities to issue early warnings of a financial crisis (eg in a particular market sector, such as property or “shadow banking”), but there is a risk that the warnings would be self-fulfilling if they became public. Another option is to make recommendations for countercyclical changes in capital buffers, liquidity buffers and requirements for collateral and margin, but these depend on the authorities being able to judge the state of the economic cycle and correctly price risk, which proved difficult last time.

None of these changes is straightforward. Whatever the changes, it is clear that the quality of supervision – both of individual financial institutions and of the financial system as a whole – is at least as important as the precise regulations themselves; and that, rather than assessing individual regulatory measures in isolation, it is the cumulative impact of the measures on the financial system that needs to be assessed.

### Crisis resolution

While the authorities are taking all the steps they can to prevent another financial crisis in due course, they recognise that these steps will never remove the risk entirely. There is still a risk in future that financial institutions will continue to fail. If they do, the political imperative is to eliminate, or at least minimise, the need for future taxpayer support. So the question is how next time to resolve one or more failing financial institutions without resort to the taxpayer, at least on the scale of the crisis last time, while avoiding damage



to the financial system as a whole and the prospects for the wider economy.

Resolving a complex financial institution involves sorting out which of its parts should be allowed to fail and which parts need to continue to function and how.

- One option being considered is to create a “firewall” in the form of a separate subsidiary which contains the essential activities of the financial institution concerned and which is ring-fenced within the wider group so that, if the institution fails, the subsidiary can be taken over quickly by government at limited cost, and so that the taxpayer does not need to support the institution as a whole. But that involves making judgments about which activities should be included within the ring fence; how well the ring fence would work in a crisis; and what the costs would be, in particular whether the cost of capital would increase.
- Resolving a complex financial institution without cost to the taxpayer is also likely to involve “bailing in” at least some of its bondholders and imposing losses on them. That could increase the cost of raising capital through the markets in future. Protecting ordinary retail depositors by ranking their claims above those of other unsecured creditors may have a similar effect.

Nor is it necessarily clear in a crisis where the dividing line should be drawn between financial institutions which are systemically important and those which are not: is the dividing line the same as in stable market conditions, or in a crisis are nearly all financial institutions of potential systemic significance, because of the interdependencies between them, as appeared to be the case last time? When assessing new measures designed to make the financial system more robust without the need for taxpayer support, a key question is whether they would have prevented the last crisis if they had been introduced in time, and what degree of certainty there is that they will prevent the next one, which may well be different.

## International coordination

It is widely accepted in principle (eg in the G20) that measures for both crisis prevention and resolution need to be coordinated internationally: through the Financial Stability Board at global level; the European Systemic Risk Board at European level; and at national level through committees like the Financial Policy Committee in the UK. These bodies all need to work together. And there is a broad measure of agreement at a high level in the G20 about what needs to be done. But implementing this high level agreement in the same

way in different regulatory jurisdictions is proving difficult in practice. Consequently, there is a risk of regulatory arbitrage between different jurisdictions (eg between the EU, the US and Asia), and also between the regulated sectors of the market and the less regulated sectors, such as “shadow banking”, which are not subject to the same regulatory constraints and may be less transparent. Heavier regulatory requirements on the established financial system may even encourage financial activity to shift to the non-regulated sector.

The need for international coordination also reduces the scope for national discretion. The scope for national discretion is particularly limited in the EU, where financial services legislation is agreed at EU rather than national level, and new EU authorities – ESMA, EBA and EIOPA – have been established this year to create a Single EU Rulebook. If, for example, a national authority were to raise capital levels for bank subsidiaries in one EU country without them being raised elsewhere in the EU, foreign banks might be able to gain a competitive advantage by making use of their lower capital level elsewhere in the EU and passporting through their local branches. But removing national discretion in the EU altogether – eg the discretion to allow national regulators to impose national requirements above a common minimum level set for the EU as a whole – would risk imposing a “one size fits all” solution to economic and financial problems in different countries, which are not all the same.

Finally, the post-crisis regime appears to have strengthened the need for coordination between central banks and government, in two ways. One relates to the need for central banks – even though they are operationally independent – to work closely with government when interest rates are close to zero. The other relates to the increased importance attached to financial stability since the crisis. As a result, central banks need to achieve twin objectives: not just the objective of achieving monetary stability by having operational independence to set short-term interest rates in order to hit an inflation target; but also the objective of achieving financial stability, which requires close coordination with government. These two objectives should be consistent with one another in the longer term, but in the short term they are not necessarily the same.

## The European context

There are two other relevant issues – of particular importance for markets in Europe – to take into account. One is the impact of the sovereign debt crisis in Greece, Ireland and Portugal, which has arisen partly because of overstretched public finances in these countries, partly because of the degree to which their public deficits depend on external financing, and

partly because of the related need (eg in Ireland) to recapitalise the banks. The European authorities have stepped in with the IMF to provide official financial support, conditional on policy changes in the recipient countries designed to reduce their public deficits and increase their competitiveness.

But the perception has grown in the market that the policy changes agreed so far will not be sufficient without sovereign debt restructuring in one form or another. And the prospect of sovereign debt restructuring raises difficult issues. How should affected sovereign debt be valued when stress-testing the banks? Should restructured debt still qualify as a liquid asset and be eligible for use as collateral? Would restructuring in one part of the euro area create contagion elsewhere? And while restructuring would reduce the burden on the public finances, it could increase the requirement to recapitalise local banks which own government securities in question, and it would impose losses on foreign banks and investors. Underlying these questions is the market perception that, if governments in the euro area do not integrate their finances further, ultimately there is a risk that parts of the euro area may fragment.

The other issue is the relatively high dependence on bank finance and relatively low use of the international capital market to finance economic activity in Europe, by comparison with the US. Greater use of the capital market in Europe would not only help to recapitalise the banks themselves but also, by reducing reliance on the intermediating role of those banks whose balance sheets have been weakened by the crisis, make it easier to finance the economic recovery.

## Conclusion

This Quarterly Assessment has described, in summary form, the changing international context within which ICMA continues to set standards of good market practice in the international capital market in order to make the market more efficient and safe. Market intelligence on the regulatory proposals in prospect, together with an outline of the practical steps that ICMA is taking on behalf of its members, on both the sell side and the buy side, is set out in the report which follows.

**Paul Richards**  
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## Recent practical initiatives by ICMA

### Sovereign bond markets

1. We have continued our work on sovereign bond documentation relating in particular to the transparency of contractual terms and to collective action clauses; and we have participated in meetings with the European Sovereign Debt Markets Group, chaired by Philippe Mills of the AFT; certain individual Debt Management Offices in the EU; the European Central Bank; the European Commission; and the European Financial Stability Facility.
2. ICMA's Chief Executive has written to all ICMA members concerning how ICMA might assist them in the context of Greek sovereign debt; and related information continues to be made available through ICMA's [Sovereign Debt Information](#) website page.
3. We have issued guidance on buybacks by EU sovereign and sovereign agency issuers and by supranational issuers, in consultation with the ICMA AMTE Council.

### Short-term markets

4. The GMRA 2011 has been launched, together with an adoption Protocol, and legal opinions have been updated.
5. The ICMA ERC Committee has commented on the repo-oriented aspects of the European Commission's consultation on financial sector taxation.
6. An ICMA staff paper has been circulated to our ECP and ERC Committees setting out details of the Basel definition of liquid assets for liquidity coverage ratio purposes.

### Primary markets

7. ICMA has submitted a response to the European Securities and Markets Authority's (ESMA's) consultation concerning its guidelines on the application of the endorsement regime under Article 4(3) of the EU Credit Rating Agencies Regulation.
8. ICMA is responding to ESMA's consultation on its technical advice to the European Commission on Level 2 of the review of the EU Prospectus Directive.

## Recent practical initiatives by ICMA - continued

9. An updated version of the ICMA *Model Form Selling Restrictions* – to reflect the recent publication of amendments to the Prospectus Directive – has been circulated to members.
10. We have held a Retail Bond Workshop in Luxembourg, in collaboration with ABBL and the Luxembourg Stock Exchange, for our Luxembourg members and others, to discuss the implications of changes in the Prospectus Directive, including the change in the minimum threshold from €50,000 to €100,000.
11. The Joint Associations Committee (involving ISDA, AFME and ICMA) on retail structured products has responded to the UK FSA's Discussion Paper on *Product Intervention*.
12. Following earlier submissions, ICMA has responded to the UK Treasury's consultation on *A New Approach to Financial Regulation: Building a Stronger System*, focusing on the role of the UK Listing Authority in the future Financial Conduct Authority.
13. A further Allocations Roundtable has been held at ICMA, involving issuers, lead managers and investors, to discuss pre-sounding, bookbuilding and allocation policy for new issues.
14. ICMA's annual Primary Market Forum, held this year at Allen & Overy, focused on: the state of the primary debt capital markets; regulation and documentation; and our sovereign bond market work.
15. Following our Usage Review, we are planning to reorganise the ICMA Primary Market Handbook and revise it, where necessary: to delete obsolete provisions; to amend provisions to reflect current market practice; and to ensure that it is internally consistent. The work is being overseen by the ICMA Legal & Documentation Committee, chaired by Kate Craven of Barclays Capital.

### Secondary markets

16. We are continuing to coordinate closely with other trade associations, including AFME, ISDA and the FOA, on the European Commission's MiFID review. Legislative proposals are currently expected from the Commission in the autumn.
17. Following our survey of members on the Usage Review, we have reconstituted the ICMA Secondary Market Practices Committee: to make sure that our Secondary

Market Rules and Recommendations are as relevant as possible to members; and to help them prepare for the implementation of new regulatory changes in a cost-effective manner.

18. We are developing proposals to strengthen our Secondary Market Rules and Recommendations in the key area of settlement discipline.

### Asset management

19. The ICMA Covered Bond Investor Council has consulted on proposals for the transparency of all covered bond issuance on a national basis with the objective of producing a widely agreed standard for issuers in September.
20. With the help of our Private Banking Working Group, we are planning to organise a cross-border private banking conference for our members and others in the early part of 2012.

### Market infrastructure

21. We are continuing to support Godfried De Vidts, Chair of the ICMA ERC Committee, who has been participating in the European Commission's Expert Group on Market Infrastructure (EGMI) to represent our members' interests, especially – but not only – in the repo market, and to seek to ensure that EGMI's recommendations take account of the specific needs of our markets.
22. The ICSDs (Euroclear and Clearstream) have put forward their proposals for Issuer and Issuer Agent Letters of Representation linked to an ICSD Market Practice Book. ICMA has observer status on the ISMAG, which the ICSDs consult on the project. ICMA has previously endorsed a *Guidance Note on the Provision of Information and Documents to Intermediaries*.
23. A short letter has been sent to DG Competition at the European Commission, highlighting the importance of market access to suitably standardised and harmonised unique reference data elements (such as ISINs), and legal entity identifiers.

### Other engagement with regulators

24. With our members, we have also held meetings with senior representatives of the ECB, ESMA, the Bank of England, UK Treasury, Commission officials and a number of national regulators.

## G20 financial regulatory reforms

As reported in its [5 April press release](#), the Financial Stability Board (FSB) met in Rome. In brief this release reports the following:

- *Vulnerabilities in the financial system:* The ongoing international programme of financial reforms is strengthening the robustness of the global financial system. However there is a need to decisively press ahead with the repair and strengthening of weak banking systems, using the forthcoming rounds of stress tests to address expeditiously any weak points identified. Developments in exchange-traded funds, commodities and high-yield markets are examples that warrant closer surveillance by regulatory authorities. In a number of emerging markets economies, rapid credit growth and portfolio inflows have raised the risks of asset price inflation and other financial imbalances. The FSB also discussed macroprudential measures taken in a number of countries to reduce resulting financial system vulnerabilities.
  - *Key financial regulatory reforms:*
    - *Addressing systemically important financial institutions (SIFIs):* The FSB discussed progress in work to identify global SIFIs (G-SIFIs) and approaches to assessing the added loss absorbency that such institutions should meet. It also discussed progress in work to enable the orderly resolution of such financial institutions. It agreed an accelerated timetable and processes, including public consultation, to deliver the G-SIFI recommendations to the G20 Summit in November.
    - *Reforming OTC derivatives markets:* The FSB reviewed progress in the implementation of the recommendations set out in its [October report](#) covering standardisation, central clearing, exchange or electronic platform trading, and reporting to trade repositories. The FSB emphasised that all jurisdictions need to take immediate, concrete steps to ensure that the G20 commitments can be implemented in an internationally consistent manner by the agreed end-2012 date. The FSB welcomed the publication of the consultative report by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO) on harmonised principles for financial market infrastructures and the IOSCO report on trading of OTC derivatives on exchanges or organised trading platforms.
  - *Shadow banking:* The FSB approved the proposed approach by its task force to develop recommendations to strengthen the regulation and oversight of the shadow banking system. The FSB will consider initial draft recommendations at its next plenary meeting in July and thereafter the recommendations for submission to the G20 in the autumn. The FSB will publish later this month a short background note on this work project.
  - *Data gaps:* The FSB approved proposals to progress work on a consistent template for improving the collection, and sharing among relevant authorities, of data on systemically important financial institutions. Preparatory work will also commence on strengthening data sharing arrangements and protocols within the official sector.
  - *International cooperation and information exchange initiative:* The FSB reviewed the status of evaluations underway and agreed on the next steps in the [initiative](#).
  - *Regional consultative groups:* The FSB discussed the operational framework for six FSB regional consultative groups, rolling out its [initiative](#) announced on 3 November 2010.
- On 12 April, the FSB published a note, [Shadow Banking: Scoping the Issues](#), which provides information on the work of the FSB to develop recommendations to strengthen the oversight and regulation of the shadow banking system.
- Prompted by the G20, the FSB has formed a task force to develop initial recommendations for discussion that would:
- clarify what is meant by “the shadow banking system”;
  - set out potential approaches for monitoring the shadow banking system; and
  - explore possible regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking system.
- The note sets out the current thinking of the task force – in particular on the first item. It proposes that monitoring and policy responses should be guided by a two-stage approach: first, by casting the net wide to cover all non-bank credit intermediation so as to identify potential areas where new risks might arise; and then, second, by narrowing the focus to those parts of the system where maturity/liquidity



transformation, flawed credit risk transfer, and/or leverage create important systemic risks.

Based on the work of the task force, the FSB will consider initial draft recommendations at its July plenary meeting and thereafter the recommendations to be submitted to the G20 in the autumn. The FSB invited comments from the public on this note, which were to be submitted by 16 May (ICMA's AMIC responded as reported further below).

As reported in a [post-meeting communiqué](#), the G20 Finance Ministers and Central Bank Governors, met in Washington DC on 14-15 April. With respect to financial regulation this includes (in paragraph #7) the following points of note:

- “We took stock of progress made to determine a cohort of global SIFIs and confirmed that the FSB will make recommendations on a multi-pronged framework with more intensive supervisory oversight, effective resolution capacities and higher loss absorbency capacity. We look forward to public consultations on SIFI recommendations and request a macroeconomic impact study by FSB and BCBS, in cooperation with BIS and IMF, to be reviewed at our next meeting.
- We welcomed the FSB work on the scope of shadow banking and look forward to the recommendations that the FSB will prepare for our next meeting on the regulation and oversight of the shadow banking system.
- We committed to set high, internationally consistent, coordinated and non-discriminatory requirements in our legislations and regulations implementing FSB recommendations on OTC derivatives markets and stressed the need to avoid overlapping regulations.
- We welcomed ongoing work of OECD and FSB and other relevant international organizations to develop common principles on consumer protection in financial services.”

Separately, the [twenty-third meeting of the IMFC](#) (International Monetary and Financial Committee) of the Board of Governors of the International Monetary Fund is reported in a 16 April communiqué. In particular, in the paragraph on global financial stability, this says:

- “We are committed to accelerate efforts to strengthen the resilience of the financial sector and its ability to support economic recovery.
- Further progress is needed to address excessive financial risk taking and moral hazard, and strengthen supervision and regulation in financial centers. Recent international agreements on enhancing financial regulation must now be implemented and accompanied by more effective supervision.

- More cooperation and progress are needed to address risks posed by global systemically important financial institutions, including through heightened prudential standards, and on cross-border resolution.
- We call for enhanced financial sector oversight of risks related to shadow banking activities and agree to maintain momentum to tackle non-cooperative jurisdictions.”

As of 15 April, the FSB issued a report [dated 10 April](#) to the G20 Finance Ministers – entitled *Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability*. This report focuses on international policy development and implementation that has taken place since the G20 Finance Ministers meeting in February. Points covered in this report include:

- implementation of reforms to bank capital and liquidity standards;
- addressing SIFIs – G-SIFI determination and loss absorbency; resolution tools and regimes; and supervisory intensity and effectiveness;
- shadow banking;
- improving the OTC and commodity derivatives markets;
- developing macroprudential frameworks and tools;
- progress towards convergence on strengthened accounting standards; and
- strengthening adherence to international supervisory and regulatory standards.

The FSB, together with the IMF and the BIS, has issued an [18 April press release](#), entitled *High-Level Conference Discusses Ways to Reduce Global Financial Risk and Improve Macroprudential Regulation*. Macroprudential regulation has become the new frontier of policy development to strengthen financial systems inside countries and across borders. Generally, it is defined as policy that uses primarily prudential tools to limit systemic or system-wide financial risk. However, beyond that general definition, the understanding of how and when to use what instruments in which situation remains at an early stage. Developing a policy framework to fill these gaps is an urgent challenge and has become the subject of widespread interest among policymakers and academics. Participants agreed that more analysis and empirical experience will greatly benefit the design, calibration, and assessment of the effectiveness of macroprudential tools.

In a [25 June press release](#), the BIS announced that measures for global systemically important banks have been agreed by the Group of Governors and Heads of Supervision (GHOS). These measures, which are contained in a consultative

document, include the methodology for assessing systemic importance, the additional required capital – ranging from 1% to 2.5% of extra common equity against risk weighted assets – and the arrangements by which they will be phased in. The GHOS is submitting this consultative document to the FSB, which is coordinating the overall set of measures to reduce the moral hazard posed by global systemically important financial institutions. This package of measures will be issued for consultation in late July.

The BIS has also announced that the GHOS has appointed Stefan Ingves, Governor of Sveriges Riksbank (Sweden's central bank), as the new Chairman of the Basel Committee on Banking Supervision. Mr Ingves succeeds Nout Wellink.

In its media release of 20 April, IOSCO reported the opening of its Annual Conference public sessions, focusing on the themes of securities regulators and systemic risk, the challenges of debt markets, international corporate governance and consumer education. The public conference came at the conclusion of IOSCO's private meetings which have resulted in the decision by the Presidents' Committee to approve a new organisational structure and funding basis.

IOSCO also published a briefing note outlining the decisions reached at this year's Annual Conference. This covers points on Strategic Direction; Objectives and Principles; the Multilateral Memorandum of Understanding (MMoU); the Initiative to Raise Standards of Cross-Border Cooperation; New Work Mandates (in relation to the Emerging Markets Committee); the SRO Consultative Committee; and Reports approved for publication.

It also reports on appointments made during the Conference. These include that of Maria Helena Santana, Chairperson of the Comissão de Valores Mobiliários (CVM) of Brazil, who has been appointed Chairman of the Executive Committee to replace Jane Diplock AO, Chairman of the New Zealand Securities Commission, who has stepped down; and that of Masamichi Kono, Vice-Commissioner for International Affairs, Financial Services Agency of Japan who has been appointed Chairman of the Technical Committee to replace Hans Hoogervorst, Chairman of the Netherlands Authority for the Financial Markets (AFM), who has stepped down.

It has also been reported that Liechtenstein has become the newest IOSCO member; and that nine securities regulators are to join IOSCO's fight against cross border market misconduct, having been invited to become full signatories of the IOSCO MMoU.

## Crisis management

In March, ICMA submitted a response to the European Commission in respect of its "bail-in" consultation (those questions laid out in Annex A of its crisis management consultation). The European Commission has now made available information regarding the responses it received to this consultation, which can be found through the Commission's crisis consultation web page. In the overview of the results the portion relating to "bail-in" is section 8 (on pages 19-23). In the list of answers (working document) the portion relating to "bail-in" starts on page 34 and ends on page 45 (covering consultation questions 62-68).

The technical details and the responses received will contribute significantly to the development of draft legislation for a comprehensive crisis management framework for banks and investment firms intended to be tabled in September.

The IMF published a staff discussion note dated 27 May which is entitled *The Too-Important-to-Fail Conundrum: Impossible to Ignore and Difficult to Resolve*. This reviews the too-important-to-fail (TITF) problem and considers whether current policy proposals will resolve it. In summary this paper states the following conclusions and policy implications:

- no private financial institution should be viewed by markets as being too important to be allowed to fail;
- policies are therefore needed to address the systemic risk posed by institutions perceived as TITF and to reinstate market discipline;
- these policies should be accompanied by certain key elements to reinforce their effectiveness and limit their unintended consequences;
- although clear progress has been made in some of these areas, tangible results are needed on a number of issues;
- these complex issues have been under intensive discussion for many months within international forums, and they involve difficult policy judgments; and
- in the interim, a subset of the measures that are simple and straightforward could be implemented internationally on a consistent basis.

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As described in its [6 July press release](#), the Basel Committee on Banking Supervision (BCBS) issued a progress report on resolution policies and frameworks. The key findings of the report are:

- progress has been made in many jurisdictions with the adoption of special administrative resolution regimes aimed at the maintenance of financial stability and the protection of depositors. A critical feature of these regimes is to transfer part or all of a failing bank's assets, liabilities and financial contracts to a bridge bank;
- some jurisdictions continue to lack these and other important legal powers set out in the BCBS's 2010 recommendations or continue to rely on general corporate insolvency procedures. Such procedures are too slow, too costly and come too late to resolve a failing bank in manner that ensures continuity of its essential financial functions;
- further work is required on cross-border resolution as complications continue to arise from discrepancies among national regimes. In particular, these relate to legal powers, the ranking of depositor and other creditor claims, and the capacity of national authorities to share information and coordinate actions with resolution authorities in other jurisdictions;
- the legal, operational and cross-border complexities underline the crucial importance of effective contingency planning and the need for actions that reduce unnecessary complexity and promote resolvability. Some jurisdictions are working on solutions that involve improved risk management or reductions of intra-group guarantees;
- national authorities appear to be at different stages of developing recovery and resolution plans for systemically important financial institutions. In view of the importance of these plans for systemic stability, national authorities will need to move forward quickly in this area; and
- the BCBS's report stresses the need to accelerate reforms of domestic resolution regimes and tools and of frameworks for cross-border enforcement of resolution actions.

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## European financial supervision

On 17 May, the European Securities and Markets Authority (ESMA) [publicised the composition](#) of its Securities and Markets Stakeholder Group, including details of a list of alternates who will be called upon to fill any vacancy that arises (ICMA's President, René Karsenti, is one of the alternates selected to represent financial market participants). This Group has been set up to help facilitate consultation with stakeholders in areas relevant to the tasks of ESMA. The Group will be consulted on actions concerning regulatory technical standards and implementing technical standards. The Group, which will meet at least four times per year, is made up of 30 stakeholders from various areas, of which a minimum of 5 representatives are retail investors and 5 academics. A [call for expression](#) of interest, which provides further details on the role and composition of the Panel, was published by CESR on 26 November.

The European Banking Authority (EBA) announced the composition of its [Banking Stakeholder Group](#) on 18 March; and the European Insurance and Occupational Pensions Authority (EIOPA) announced the [members of its two stakeholder groups](#), the Insurance and Reinsurance Stakeholder Group as well as the Occupational Pensions Stakeholder Group, on 8 March.

The [General Board](#) of the European Systemic Risk Board (ESRB) [held its second regular meeting](#) on 22 June. It had a thorough review of the systemic risks to which the financial system of the European Union (EU) is exposed. It concurred that the most serious threat to financial stability in the EU stems from the interplay between the vulnerabilities of public finances in certain EU Member States and the banking system, with potential contagion effects across the EU and beyond. The General Board also elected Jens Weidmann, President of the Deutsche Bundesbank, as member of the Steering Committee, to replace Axel Weber; and supported the nomination of Francesco Mazzaferro, who was performing this function on an acting basis, as Head of the ESRB Secretariat.

On 21 June there was also the first meeting of the ESRB's [Advisory Scientific Committee \(ASC\)](#), under the chairmanship of Professor Martin Hellwig. The ASC discussed its own work programme for 2011 and also identified priorities. It will work on a wide set of issues, ranging from research topics on systemic risks to more policy-oriented questions, in support of the ESRB activities.

A conference jointly organised by European Commission and European Central Bank (ECB) was held in Brussels on 2 May. This is an annual event in relation to the simultaneous release of the ECB and Commission reports on *Financial Stability and Integration* (next year's event will be in Frankfurt). The conference focussed on the implications of the new EU supervisory architecture and of the ongoing EU crisis management initiatives.

Key messages in the ECB's report are:

- Euro area capital markets have continued to increase in overall size in recent years, and the cross-country dispersion in terms of size relative to GDP has continued to decline. All in all, the crisis should not endanger the long-run trend towards financial market development and integration in Europe.
- However, the worsening of the fiscal situation in a number of countries is posing serious challenges to financial integration. The money and bond markets have suffered particularly strongly, as evidenced by several indicators.
- The sharp divergence of yields in the European government bond market reflected an increase in sovereign risks as well as liquidity risks, possibly exacerbated by market over-reaction. Persistent liquidity risks are a threat to market integration.
- The ECB Governing Council adopted several measures to support the smooth transmission of monetary policy and restore market confidence, and this had beneficial effects on market integration. National and European authorities also adopted several measures to support financial markets and individual intermediaries, while safeguarding competition. In some cases, these interventions may have induced a retrenchment of financial activities within national borders.
- The euro area equity markets were less strongly affected by the recent developments. Most available indicators suggest that the equity market integration actually strengthened in 2010.
- The integration of bond and equity markets relies greatly on the functionality of the underlying infrastructures, notably securities settlement systems and central counterparties. Of particular significance in this area is T2S, the Eurosystem's pan-European securities settlement platform which is intended to come into operation in 2014.
- While banking markets have shown signs of normalisation, particularly of lending conditions, this process is rather slow. A key factor in the loss of financial integration in

banking during the crisis was the absence of clear and internationally consistent crisis management and bank resolution arrangements. More European solutions are needed in this area.

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## OTC (derivatives) regulatory developments

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As stated in its [15 April press release](#), the FSB has published a progress report on *Implementation of OTC Derivatives Market Reforms*. The report summarises progress made toward implementation of the G20 commitments concerning standardisation, central clearing, exchange or electronic platform trading, and reporting of OTC derivatives transactions to trade repositories. Major implementation projects are underway in the largest OTC derivatives markets, and international policy development is proceeding according to the timetable set out in the [FSB's October report](#):

- The CPSS and IOSCO published in March a consultative report on harmonised principles for financial market infrastructures, covering payment systems, central securities depositories, securities settlement systems, and central counterparties (CCPs), and including guidance on trade repositories.
- IOSCO published in February a study evaluating the benefits and challenges associated with the implementation of measures aimed at increasing exchange and electronic trading. It will conduct further analysis on the current market use of multi or single-dealer platforms.
- The largest derivatives dealers and other major market participants delivered in March a letter to the OTC Derivatives Supervisors Group, setting out broad objectives, specific initiatives and supporting commitments in this letter as the foundation of a roadmap for implementation of G20 objectives.
- The Committee on the Global Financial System (CGFS), CPSS, and IOSCO held a forum in January and are organising follow-up work to promote expanding access to central clearing to a broader set of participants, and links between CCPs, without sacrificing the rigour of CCP risk controls.



Nevertheless, although implementation is still in its early stages, the FSB is concerned that many jurisdictions may not meet the G20's end-2012 deadline. Differences in approaches are emerging in some areas that could weaken the effectiveness of reforms in these markets. The FSB will publish a further progress report by October 2011.

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## Credit rating agencies

Dated 31 May, the revised [Credit Rating Agencies \(CRA\) Regulation](#), establishing ESMA's responsibility for the supervision and registration of CRAs in the EU, has been published in the Official Journal. Whilst this already formally changes the original CRA Regulation, itself only published in the Official Journal on 17 November 2009, further changes are already being debated – as reflected in the European Parliament's 8 June press release, [Beefing up credit rating agency rules](#). This refers to a non-legislative resolution, drafted by MEP Klinz, and approved by a show of hands, which comes some weeks before the European Commission is to table legislative proposals. Amongst other things this European Parliament resolution advocates making CRAs liable in civil law for their ratings; creating a European credit rating foundation; and that special attention be paid to sovereign debt ratings.

On 18 March, ESMA published its consultation paper – [Guidelines on the Application of the Endorsement Regime](#). The purpose of this consultation was to seek comments on the content of these guidelines. In accordance with the 31 March deadline for comments, ICMA submitted [a short response](#). The question asked in the consultation paper revisits one previously raised by CESR. ICMA reiterated the view which it expressed at that time – namely that, as a pre-condition for allowing endorsement, the CRA regulation does not require that third country regulation contain enforceable rules that are “as stringent as” those in the EU regulation. ESMA has published ICMA's response, alongside the [other responses](#) it received.

On 18 May, ESMA [issued a press release](#) announcing the outcome of this consultation and the publication of its finalised [Guidelines on Endorsement](#). ESMA acknowledged the concerns raised by markets participants in respect of the application of the endorsement regime. However, ESMA confirmed the application of Article 4(3)(b) requiring that

the local legal and regulatory systems in third countries be “as stringent as” those set out in Articles 6 to 12 of the EU Regulation – as initially adopted by CESR in its June 2010 Guidance. Finally, as stated in its Guidance on endorsement, ESMA is of the view that compliance with Article 4(3) should be at the date of registration of any CRA which applied before 7 September 2010 (these 18 May papers seek to ensure that transition timing is clearly spelt out).

On 6 June, ESMA published a press release [announcing an exchange of letters](#), establishing the cooperation framework between the EU and Japan for CRAs.

On 14 April, ESMA published its consultation paper – [Technical Advice to the Commission on Fees for CRA Supervision](#). ESMA has [published the responses](#) it received. The advice, which was due to be delivered to the Commission by 13 May, will be adopted by the Commission in the form of a delegated act. ESMA published its [final technical advice](#) on 17 May.

On 26 May, ESMA published two further calls for evidence. The first is on the [assessment of compliance of CRAs with Article 8.3](#) of the CRA Regulation; and the second on [ratings data periodic reporting requirements](#) for CRAs according to Article 21 (3)(e) of the Draft Amended CRA Regulation. The respective [responses were subsequently published](#).

On 18 May, the US Securities and Exchange Commission (SEC) voted unanimously to [propose new rules and amendments](#) intended to increase transparency and improve the integrity of credit ratings. The proposed rules would implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act and enhance the SEC's existing rules governing credit ratings and Nationally Recognized Statistical Rating Organizations (NRSROs). Under the SEC's proposal, NRSROs would be required to:

- report on internal controls;
- protect against conflicts of interest;
- establish professional standards for credit analysts;
- publicly provide – along with the publication of the credit rating – disclosure about the credit rating and the methodology used to determine it; and
- enhance their public disclosures about the performance of their credit ratings.

The SEC's proposal also requires disclosure concerning third-party due diligence reports for asset-backed securities.

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## Sovereign bond markets: collective action clauses and transparency

As reported in the [Second Quarter Newsletter](#), ICMA – supporting the work of the Economic and Financial Committee's (EFC's) [EU Sovereign Debt Markets Group](#) – has been actively discussing and considering the best ways in which to formulate collective action clauses (CACs) in euro-area sovereign securities, as anticipated by the European [Council conclusions of 25 March](#). The topics of disenfranchisement and aggregation are particular aspects where ICMA is still actively focusing some more thinking, including through discussions at a 16 June meeting of ICMA's Sovereign Bond Working Group (SBWG).

It is worth noting that the 25 March Council conclusions call for “the use of identical and standardised clauses for all euro-area Member States”. ICMA notes that the [Treaty establishing the European Stability Mechanism](#), as published following the 11 July Eurogroup meeting, includes a similar reference to CACs, effectively binding euro-area Member States to give effect to the 25 March conclusions. The EFC's EU Sovereign Debt Markets Group, working in partnership with the ECB and the European Commission, are developing an agreed form of CAC language to support the consistent implementation of this high-level treaty obligation. ICMA has been feeding views into this debate and will respond to the limited consultation which is being officially conducted. Notwithstanding these steps, euro-area Member States will each be left to implement these CACs at national level, in a way consistent with specific local legal requirements and contractual provisions.

ICMA continues to believe that the legal and operational effectiveness of such CAC provisions depends directly on them being clearly disclosed to investors. This underpins ICMA's concern to promote full transparency of sovereign bond terms. This concern stems from respondents' feedback to the ICMA sovereign bond survey in late 2010, which indicated that there is strong support from members for the terms and conditions of all sovereign issues to be made readily available, including an English language version for all euro-area sovereign issues, as they are all potentially held by investors across national borders.

More broadly, financial news continues to reflect significant difficulties being experienced in the euro sovereign sector. One of ICMA's key roles is to ensure that all its members are kept fully up to date on these developments. Related information, including a 5 July message to all ICMA members concerning how ICMA might assist them in the context of Greek sovereign debt, can be sourced through ICMA's [Sovereign Debt Information](#) website page.

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## Euro Commercial Paper market

*Liquidity regulation:* The IMF has published *How to Address the Systemic Part of Liquidity Risk*, as Chapter 2 of its April 2011 *Global Financial Stability Report*. This stresses why more needs to be done to develop macroprudential techniques to measure and mitigate systemic liquidity risks and offers some initial thoughts about how to do it. A priority should be to design some type of assessment capturing the negative effect that one institution's liquidity risk management decisions could inflict on the rest of the financial system. This would allow financial institutions to bear more of the burden they place on central banks and governments. This can be achieved through a macroprudential tool that could be in the form of a capital surcharge, a fee, a tax, or an insurance premium. But such a tool presupposes that policymakers have a robust methodology for measuring systemic liquidity risk and each institution's contribution to this risk.

The chapter proposes three different approaches, all three of which capture the risks across time and across institutions, to measure systemic liquidity risk; and macroprudential tools to mitigate it. The chapter further emphasizes that the regulatory approach to addressing systemic liquidity risk should be multipronged and include:

- measures to make funding markets work better by strengthening the infrastructure underpinning them;
- requiring greater oversight and regulation of non-bank financial institutions that contribute to systemic liquidity risk;
- closer international coordination and greater disclosure of financial information on relevant funding markets and the maturity of assets and liabilities; and
- better evaluation of the overall cost effectiveness of various macroprudential tools.

*Money market funds:* On 10 May, the SEC hosted a roundtable discussion on money market funds (MMFs) and systemic risk, which addressed:

- the potential for money market funds to pose a systemic risk to broader financial markets – what makes money market funds vulnerable to runs and how should the role of money market funds be viewed through the prism of systemic risk analysis; and
- possible options for further regulatory reform and their implications, including floating NAV, bank regulation, and options that reflect a hybrid of these regulatory approaches: a private liquidity bank; mandatory reserve or capital requirements; and liquidity fees.

As per its 4 April press release Fitch has updated its global rating criteria for MMFs. The criteria update, which is part of Fitch's periodic review of all rating criteria, provides added transparency in light of the globally evolving regulatory landscape for MMFs. The report clarifies and updates certain elements of Fitch's MMF rating criteria. However, the core analytical framework, as outlined by Fitch in October 2009, remains unchanged. As such, no rating actions are expected as a result of the updated criteria. Key changes to the criteria include:

- expanded rating criteria to encompass the portfolio and operating parameters of MMFs rated AAmmf and Ammf, which may be particularly relevant in light of the pan-European definition of MMFs;
- updated diversification criteria for direct, indirect and collateralised exposures in MMFs, including exposures to the fund's sponsor or parent;
- an update of those assets recognised for daily and/or weekly liquidity and explicit recognition of committed liquidity facilities, when available; and
- clarified treatment of counterparty risk in repurchase agreements.

Largely consistent with the proposals it outlined in 2010, Standard and Poor's announced on 8 June the publication of its updated principal stability fund ratings criteria. The main criteria changes, which all become effective on 1 November, include:

- establishment of explicit issuer or counterparty credit ratings (or the requirement to have a formal guaranty from a Standard & Poor's rated entity) for counterparty transactions such as repurchase agreements, reverse repurchase agreements, swaps, forward purchases, foreign-exchange contracts, and other hedging positions;
- adoption of weighted average maturity (WAM) to final, or WAM(F), criteria for all PSFR categories (ie AAAM maximum of 90-120 days); and
- establishment of a maximum final maturity of 397 days for all investments other than certain AA- or higher-rated sovereign floating-rate securities or securities with an unconditional demand feature (ie put) providing for liquidity within 397 days.

*CRD's implications for ABCP structures:* On 11 May, the FSA published its [consultation paper CP11/09](#), entitled *Strengthening Capital Standards 3 – Further Consultation on CRD3*. This consultation paper is an update to CP09/29, which set out the FSA's proposals for implementing changes to the Capital Requirements Directive (CRD) from the European Commission's CRD2 and CRD3 packages of amendments. It includes a few points of detail specific to ABCP in the context of clarifying new rules regarding securitisation structures.

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## Basel III liquid asset definition in the Liquidity Coverage Ratio

The [Basel III Liquidity Coverage Ratio \(LCR\)](#) has been introduced as one response to the global financial crisis in which banks, worldwide, experienced liquidity crises. The LCR – which will come into force from January 2015, following an observation period – requires banks to hold sufficient high-quality liquid assets to survive a 30-day period of acute market stress.

Detailed rules for the LCR were finalised by the Basel Committee on Banking Supervision (BCBS) in December 2010. The BCBS has kept the list of eligible assets short, with banks' domestic sovereign bonds – which have been categorised as highly liquid, level one assets – likely to make up the bulk of the LCR buffers. At least 60% of the liquidity buffer, indeed, must comprise cash, central bank reserves, and marketable securities that represent claims on (or claims guaranteed by) sovereigns, central banks, non-central government public sector enterprises, the BIS, the IMF, the European Commission or a multilateral development bank. The remaining amount of up to 40% can include transferable assets that are of high liquidity and credit quality, such as high quality non-financial corporate and covered bonds.

For LCR purposes, high quality liquid assets are intended to meet four fundamental characteristics: (i) low credit and market risk; (ii) ease and certainty of valuation; (iii) low correlation with risky assets; and (iv) listed on a developed and recognised exchange market; as well as four market-related characteristics: (i) active and sizeable market; (ii) presence of committed market makers; (iii) low market concentration; and (iv) flight to quality considerations. The liquidity of any type of asset will be periodically reviewed by the newly established European Banking Authority (EBA) using a set of criteria including minimum trade volume, minimum outstanding volume, price stability and average volume traded.

The definition of liquid assets given by the BCBS for LCR purposes is perceived by many to be narrow; and to represent one of the major concerns when looking at the Basel III liquidity requirements. Unintended consequences in certain markets and an aggravation of financial instability may arise due to the concentration on government securities, which cannot themselves always be considered as liquid or even safe.



## Basel III liquid asset definition in the Liquidity Coverage Ratio – continued

Furthermore, the fact that corporate and covered bonds must have a “*proven record as a reliable source of liquidity in the markets (repo and sale) even during stressed market conditions*” in order to be level 2 eligible is fairly limiting. The range of acceptable corporate or covered bonds will not be flexible because it will take time to develop the required track record. Moreover, corporate and covered bonds may be liquid in some conditions but also typically have long maturities. On the other hand, commercial bills of exchange, for instance, have short maturities and can have intrinsic liquidity, but are not eligible assets.

Finally, it has been noted that required liquid assets are not liquid, but rather “locked” as they cannot be used by banks for internal use. In a crisis, the requirement could lead to central banks being forced to monetise government debt to avoid bank failures; while regulators need to be ready to release required liquid assets.

A detailed list of assets that can be included in the stock of high quality liquid assets, together with some general considerations on the definition of liquid assets in the context of the LCR, has been provided by ICMA in a paper entitled Liquid Assets under the Liquidity Coverage Ratio, which was circulated to ICMA ECP and ERC Committee members in April. ICMA will be closely following the EU implementation of this element of Basel III.

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## European repo market

*Liquidity rules:* The Basel Committee has received a number of interpretation questions related to the December 2010 publication of the Basel III regulatory frameworks for capital and liquidity and the 13 January 2011 press release on the loss absorbency of capital at the point of non-viability. Publications released on 5 July set out the first set of Basel III frequently asked questions (FAQs), which relate to the [definition of capital](#) and the [liquidity](#) sections of the Basel III framework.

Section 1 of the latter is particularly pertinent as it provides clarification on the calculation of the cap on Level 2 assets with regard to short term secured funding. A series of simple examples are laid out in respect of repo and reverse repo transactions.

*Eurepo* – Eurepo Steering Committee members, four of whom are also ICMA ERC Committee members, have reviewed the Eurepo definition in order to adapt it to the predictable rise of its usage and visibility in the coming months, thereby further enhancing the accuracy of the benchmark. Consequently the Eurepo Steering Committee adopted the following revised definition: “*Eurepo is the rate at which, at 11.00 a.m. Brussels time, one bank offers, in the euro-zone and worldwide, funds in euro to another bank if in exchange the former receives from the latter the best collateral within the most actively traded European repo market. It is quoted on a actual / 360 day basis.*”

Additionally, the Eurepo Code of Conduct, which was drafted in 2002, has been adapted to the current features of the benchmarks, as approved by Steering Committee members. The main changes are: (i) the deletion of Articles 4 (start-up number of panel banks) and 6 (rotation system); (ii) the adaptation of some wording to the present situation; and (iii) the inclusion of an exclusion rule for Steering Committee members in case of repeated non-participation in Committee meetings. The new definition and the revised Code of Conduct entered into force on 11 April.

*European Commission review:* The European Commission’s DG Markt has indicated its view that, alongside all the

other measures being taken, also the repo infrastructure will be analysed and appropriate regulatory measures taken if needed. Its intention is to analyse, in depth, the repo market, the triparty product and the ERC's recent initiative to have interoperability between both ICSDs; as well as the use of collateral management services, central clearing etc. It is clear that the Commission want to fully understand the "hidden" costs of settlement, why inefficiencies remain and who/what are the obstacles that continue to be an issue for the repo and triparty market.

*Crisis resolution:* On 6 January, the European Commission [launched a consultation](#) on technical details underpinning its proposed crisis resolution framework. Comments were requested by 3 March and the ERC [submitted a response](#) concerning repo-oriented aspects. The Commission has now made available information regarding the responses it received to this consultation, which can be found through the Commission's [crisis consultation web page](#).

Of particular relevance to the points made in the ERC's response:

- in the [overview of the results](#) the portion relating to "temporary suspension of rights" is section 5.2.12 (on pages 12-13) and the related point on safeguards is covered at 5.3.2 (on page 15); and
- in the [list of answers](#) (working document) the portion relating to "temporary suspension of rights" is covered at questions 42-43 (pages 23-24) and the related points on safeguards are covered at questions 46-47 (pages 26-28).

The technical details and the responses received will contribute significantly to the development of draft legislation for a comprehensive crisis management framework for banks and investment firms intended to be tabled soon. More related information can be found on the Commission's [crisis management](#) web page.

*CSD Regulation:* On 13 January, the European Commission [launched a consultation](#) on Central Securities Depositories (CSDs) and on the harmonisation of certain aspects of securities settlement in the European Union. The purpose of this [consultation paper](#) is to gather input to inform legislative proposals due shortly. The deadline for replies was 1 March and the ERC submitted [a response](#) concerning repo-oriented aspects. The Commission has subsequently published a summary of responses and copies of the responses can also be reviewed via the link on the [consultation page](#).

The initiative to regulate CSDs was welcomed by almost all respondents, who shared the view of the consultation paper that CSDs play a systemically important role for financial markets and should be subject to proper regulation. The creation of a common regulatory framework for CSDs was widely seen as an important goal for European financial markets, as a European framework would promote the safety and soundness of CSDs and lead to a more competitive and robust environment for CSD activities. As to the scope and content of such a harmonisation, the responses provided a wide variety of viewpoints. Regarding wider issues around the harmonisation of securities settlement, most respondents agreed that lack of harmonisation in key areas of post-trade processes was harmful to cross-border investment. Concerning the tools to overcome lack of harmonisation in this area, different views were expressed as to the role of European legislation in this context.

*Financial sector taxation:* Dated 22 February, the European Commission (DG Taxation and Customs) launched a [public consultation on the taxation of the financial sector](#), to receive as wide as possible feedback on the ideas set out in the Commission's [Communication last October](#). In particular, the Commission was seeking views from market participants, regulators, social partners, NGOs and other stakeholders on the impact and feasibility of the various policy options, the potential design of the tax and possible problems. The feedback received from this consultation, along with the results of a thorough impact analysis currently being carried out, will help to shape proposals on the taxation of the financial sector, which Commissioner Šemeta intends to publish soon.

The ERC [submitted a short response](#), specifically answering consultation question #52 – "Some authors argue that overnight secured credit (through repos mainly) necessitates special treatment of those types of funding because of the cheap, but unstable funding leading to systemic risk." The ERC refuted the view expressed in this question, arguing that repo is the core instrument for balancing the liquidity of a financial institution and as such brings more stability into the financial market; and that accordingly a tax targeted at repo would be counterproductive.

*US accounting:* Dated 29 April, the US [FASB issued](#) an accounting [standards update](#) to improve financial reporting of repurchase agreements, the content of which is also

described in a [short summary](#). In a typical repo transaction, an entity transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Topic 860, Transfers and Servicing, prescribes when an entity may or may not recognize a sale upon the transfer of financial assets subject to repo agreements. That determination is based, in part, on whether the entity has maintained effective control over the transferred financial assets. The amendments in this update are intended to improve the accounting for these transactions by removing from the assessment of effective control the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets.

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## GMRA Protocol

ICMA has published the 2011 Global Master Repurchase Agreement Protocol to enable parties to a GMRA 1995 or GMRA 2000 to update certain provisions of their existing agreements to bring these in line with the GMRA 2011.

Parties may adhere to the Protocol by completing and delivering a standard form adherence letter to ICMA. Adherence to the Protocol amends each existing GMRA agreement between the adhering parties, in each case on the terms and subject to the conditions of the Protocol and adherence letter. A list of adhering parties will be maintained on ICMA's website.

The Protocol allows adhering parties to effect changes to their existing agreements with each other on a multilateral basis. This efficient method of updating existing agreements will assist GMRA users in benefiting from the most up to date default provisions of the GMRA.

For further information on adherence please visit the [ICMA website](#).

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## Prospectus Directive: ESMA consultation

On 15 June, the European Securities and Markets Authority (ESMA) published its long anticipated [consultation paper](#) on ESMA's technical advice to the European Commission on possible delegated acts concerning the Prospectus Directive (PD) as recently amended (see further coverage in the [First Quarter 2011 edition](#) of this Newsletter).

*Final terms:* ESMA has decided not to propose a specific format for final terms given the hugely diverse range of securities in the markets. However, and as feared, the consultation proposes a very strict and mechanical tightening on the type of information that can be included in final terms. ESMA has proposed a categorisation of all items from the PD Regulation's securities note annexes as A, B or C. Information concerning items marked A and C is to be included, respectively, in the base prospectus and (via placeholders) in final terms, whilst for items marked B placeholders may be included in the final terms but the general information (including payout formulas) must be included in the base prospectus. Aside from some very limited exceptions, no other information can be included in final terms and final terms may not modify information in the base prospectus.

At the same time, ESMA proposes that only new information that is "significant" can be included in supplements, so that non-significant information that is not allowed in final terms can only be included within PD prospectus disclosure via a full restatement of the base prospectus (though ESMA notes some potential for publishing announcements under national laws).

Prospectuses approved under the PD are, in effect, only required to include information that is specified under the PD Regulation annexes or otherwise material to investors' investment decisions. The prospectuses are not therefore required exhaustively to include every last term of the securities. Yet ESMA's proposed approach, by mechanically restricting what can go into non-approved final terms, would seem to challenge this principle in the context of issuance programmes (stand-alone issues of securities face no such challenge).

ICMA anticipates that these proposals, if adopted, will result, not just in an increase in supplements as anticipated by ESMA. In the vanilla funding space, with issuers seeking to hit infrequent and short issuance windows (often less than 24 hours in recent volatile markets), unanticipated investor

requests to include additional terms would not be able to be satisfied – potentially causing the issuer to lose its sole funding opportunity in many months. Issuers may hope that at least simple supplements relating only to changes in ratings would be approved by regulators much more swiftly than the formally allowed maximum of seven days. In other areas, many issuance programmes risk being broken down altogether (since their prospectuses may have difficulty in containing all the newly required information in an easily analysable and comprehensible form) into more specific product base prospectuses, "drawdown" prospectuses or securities notes. Some programme options that are only rarely used or consequently uneconomic might be abandoned altogether. European regulators would be likely to face a substantial increase in their workload whilst professional investors would need to familiarise themselves with a vastly increased documentation landscape.

ICMA has already, in its [response](#) to ESMA's earlier [call for evidence](#) (see further coverage in the [Second Quarter 2011 edition](#) of this Newsletter), presented what it considers to be the appropriate mechanism for the interaction of base prospectuses, supplements and final terms. In case ESMA is nonetheless minded to continue this approach, ICMA will therefore draw to ESMA's attention various specific points concerning the proposed individual classifications (e.g. the proposal that the registered or bearer nature of securities and the offer jurisdictions be fixed in the base prospectus).

*Summaries:* The ESMA proposals are equally prescriptive in relation to the summary. A strict list of includable information is again specified by reference to the PD Regulation annexes, though information from the prospectus (at least concerning risk factors) cannot be repeated in its originally intended form but must be paraphrased in some way. This prescriptive approach could cause some summaries to be misleading when read with the full prospectus. Whilst the consultation states that no format for the summary is currently being proposed, the prescriptive approach to content combined with a proposed requirement as to order of presentation seems to do just that.

The consultation also suggests a new document not contemplated by the PD itself – a drawdown summary to be attached to the final terms. ESMA suggests this document would not require approval as it could only repeat previously approved information from the summary in the base prospectus or include final terms information that is not subject to approval. In any case this would be an additional focus of work for issuers, detracting further from the purpose of programmes to facilitate issuance.



ESMA's approach to the summary effectively seems to be turning it from a useful summary of the prospectus document that helps investors in their reading of it into a short-form disclosure of the offering that would, despite ESMA's contrary statement of intention, rather encourage investors to ignore the prospectus. The important topic of short-form disclosure is being discussed in the context of the European Commission's Packaged Retail Investment Products (PRIIPs) initiative, which should perhaps be allowed to run its course prior to changes being made to the PD.

*Next steps:* As currently set out, ESMA's proposals seem likely to further increase the disincentives facing issuers in accessing EU regulated markets and providing investment opportunities to EU retail investors. ICMA will seek to draw some of these considerations to ESMA's attention when submitting its response by the 15 July deadline.

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## EU contract law feasibility study

ICMA has submitted a [response](#) to the European Commission in relation to the results of a [feasibility study](#) carried out by the European Contract Law Expert Group on a European contract law for consumers and businesses. Though the feasibility study does not formally cover the financial markets at this stage, the future possibility of a European contract law covering the financial markets is left open and it is by no means certain that there would be additional consultation if this were to be the case.

ICMA's expression of concern has centred on the natural limitations of such a new contract law in terms of non-existent case-law history and logistical limitations on the European Court of Justice's ability to swiftly settle cases. Additional concerns arise from attempts in the study to substantially rebalance contractual rights and obligations in favour of "weaker" parties – to the detriment of the principles of freedom of contract and legal certainty that are fundamental to business in general and to financial markets in particular.

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## "IPMA Handbook" becomes "ICMA Primary Market Handbook"

ICMA has rebranded the "IPMA Handbook" as the "ICMA Primary Market Handbook", with "IPMA" and "International Primary Market Association" references having been respectively changed to "ICMA" and "International Capital Market Association". The online Handbook is being updated, as are new hard copy Handbooks. Given the minor nature of the changes, hard copy Handbooks held by existing subscribers do not need to be updated.

ICMA anticipates that market participants might, in practice, use the names "IPMA Handbook" and "ICMA Primary Market Handbook" interchangeably for some time. Similarly, ICMA also anticipates that "International Capital Market Association" and "International Primary Market Association" references, as well as 'ICMA' and 'IPMA' prefixes/suffixes, concerning Handbook items might also be used interchangeably. ICMA considers that use of any of the above terminology will ultimately be understood by market participants. ICMA however expects that market participants will seek to use the updated terminology wherever practical.

ICMA is in the course of publishing an editor's note to the Handbook to further address these and a few other considerations.

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## Other primary market developments

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*Retail structured products:* On 21 April, the Joint Associations Committee (JAC), in which ICMA participates, submitted a [response](#) to the UK FSA's [Discussion Paper DP11/1 on Product Intervention](#). On 23 May, the JAC published its [Combined Principles for Retail Structured Products](#). These principles combine the JAC's 2007 principles for managing the provider-distributor relationship and its 2008 principles for managing the distributor-individual investor relationship.

*Financial regulation in the UK:* As noted in the Second Quarter edition of this Newsletter, ICMA has submitted a [response](#) to the UK Treasury's follow-up [consultation](#), *A New Approach to Financial Regulation: Building a Stronger System* (Cm 8012).

*ICMA debt selling restrictions:* ICMA has published [revised debt selling restrictions](#) and provisionally deleted, pending review, its equity selling restrictions.

*Allocations roundtable:* On 13 May, a few lead managers, issuers and investors, including members of ICMA's Primary Market Practices Committee, Asset Management and Investors Council and Issuer Forum, met to discuss new issue processes in the Eurobond markets. The roundtable sought to gather feedback on developments following ICMA's recently published [Explanatory Note XIII](#) entitled

*Pre-Sounding, Bookbuilding and Allocations* (see further coverage in the [First Quarter 2011](#) edition of this Newsletter). This in turn followed similar roundtables held in 2010 (see further coverage in the [Third Quarter 2010](#) edition of this Newsletter). ICMA is currently considering a follow-up publication concerning practices in the new issue space.

*FATCA:* Following the publication of [Internal Revenue Service \(IRS\) Notice 2011-34](#), ICMA has participated, through the International Council of Securities Associations (ICSA), in the delivery of a [submission](#) to the US Department of the Treasury and the Internal Revenue Service, which *inter alia* reiterated the main points made by ICMA in its 2010 [response to IRS Notice 2010-60](#). A recent additional point of concern relates to the "pass-thru" principle and the potential for non-US issuers of securities to be subject to FATCA and its withholding provisions in relation to interest payments attributable to any US operations of such issuers. ICMA will continue to monitor developments in this area.

*EPIM:* Further to the initial postponement, of the deadline for proposed mandatory extension of the EPIM system for ISIN allocation to MTN issuance, from 1 February to 1 July 2011 (see further coverage in the [Second Quarter 2011](#) edition of this Newsletter), the ICSDs have [announced](#) a further postponement in respect of MTNs until further notice.

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## MiFID review

The ICMA Regulatory Policy Committee (RPC) recently discussed the review of the Markets in Financial Instruments Directive (MiFID). It noted that there have been no material developments in ICMA's position since the submission made in January (see [Regulatory Policy Newsletter, Second Quarter 2011](#)). The European Commission's proposals continue to be awaited, with the latest information being that these are now not expected to be forthcoming until October.

ICMA is working on its links with other trade associations, including national associations such as the BWF and the DSDA – present as guests at this RPC meeting. Analysis is being conducted to see where there are matters upon which associations are clearly in agreement or clearly disagree. To the extent there are matters falling between these positions there will then be some further debate to see if common ground can be found on them or not. In those areas where there is agreement, the aim will be to present coordinated views on the MiFID text.

In our discussions with other associations, ICMA will be guided by the positions set out in our [response](#) to the Commission consultation which we submitted in February. In the submission, ICMA:

- encouraged the Commission to consider the full implications of its proposals;
- proposed to expand the definition of “admission to trading”;
- recommended that the Commission excludes money market instruments from MiFID;
- asked the Commission to accommodate bilateral trading and hybrid systems within the “organised trading facility” (OTF) category;
- called for the scope of the non-equity pre-trade transparency framework to be limited to large investment grade bond issues;
- supported CESR's recommendation not to introduce mandatory pre-trade transparency outside the equity market;
- advocated that the post-trade transparency framework be based on high/low/median prices published at the end of the day, with appropriate delays to accommodate the unique nature of the bond market and phased implementation of the new requirements;

- agreed that title transfer collateral for retail clients should be properly managed, but not prohibited; and
- offered to assist in the development of any further proposals in respect of the underwriting and placing process in the primary market.

A group of associations, including ICMA, wrote to Commissioner Barnier on 14 March, emphasising that allowing investors choice was compatible with transparency, safety and efficiency. The full text of the letter can be found [here](#):

At ICMA's Annual General Meeting in Paris, Stephen Maijoor, the Chair of ESMA, emphasised the role of market transparency as follows:

“As regards market transparency, MiFID already includes a regime for pre- and post-trade transparency for shares admitted to trading on a regulated market, wherever the trading takes place. When CESR advised the Commission on the MiFID review, we suggested measures to enhance the quality, timeliness and consolidation of post-trade transparency data. We also recommended introducing a similar regime for other financial instruments such as corporate and government bonds, certain structured finance products and all kinds of derivatives including CDS. The Commission followed our recommendations in its consultation on the MiFID review.”

The full text of Mr Maijoor's speech can be found [here](#).

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## Short Selling Regulation

As expected, the European Council reached political agreement on a text on 17 May.

The Council agreed a general approach on a draft Regulation on short selling and credit default swaps, which has enabled the Presidency, on behalf of the Council, to start negotiations with the European Parliament, with a view to reaching agreement at first reading.

The draft Regulation is aimed at harmonising rules for short selling and certain aspects of credit default swaps. It introduces common EU transparency requirements and harmonises the powers that regulators may use in exceptional situations where there is a serious threat to financial stability.

As the EU lacks a common regulatory framework for dealing with short selling, Member States have adopted divergent measures. The current fragmented approach limits the effectiveness of the adopted measures and results in regulatory arbitrage. It may also create confusion in the markets and impose additional costs on market participants.

The draft Regulation is intended to address these issues, whilst acknowledging the role of short selling in ensuring the proper functioning of financial markets, in particular in providing liquidity and contributing to efficient pricing:

- **Scope:** The proposal covers all types of financial instruments, providing for a response that is proportionate to the potential risks posed by short selling of different instruments. In particular, for shares of companies listed in the EU, it creates a two-tier model for transparency of significant net short positions: at a lower threshold, notification of a position must be made privately to the regulator; at a higher threshold, positions must be disclosed to the market.
- **Sovereign debt:** For sovereign debt, on the other hand, significant net short positions relating to issuers in the EU would always require private disclosure to regulators. The proposed regime also provides for notification of significant positions in credit default swaps that relate to EU sovereign debt issuers.

- **Uncovered short sales:** To tackle the increased risks posed by uncovered short sales (practice whereby an investor sells a security he does not own with the intention of buying it back when the price has fallen), the proposal requires that anyone entering into a short sale must at the time of the sale have borrowed the instruments, entered into an agreement to borrow them or made other arrangements to ensure they can be borrowed in time to settle the deal.

However, these restrictions do not apply to the short selling of sovereign debt if the transaction serves to hedge a long position in debt instruments of an issuer. Moreover, if the liquidity of sovereign debt falls below a specified threshold, the restrictions on uncovered short selling may be temporarily suspended by the relevant competent authority.

In exceptional situations that threaten financial stability or market confidence in a Member State or the EU, the draft regulation provides that competent authorities have temporary powers to require further transparency or to impose restrictions on short selling and credit default swap transactions or to limit individuals from entering into derivatives transactions.

In such a situation, the European Securities Markets Authority (ESMA) is given a coordinating role to ensure consistency between all competent authorities and to guarantee that such measures are only taken where it is necessary and proportionate to do so. ESMA is also given the power to take measures where the situation has cross-border implications. ESMA would only be authorized to intervene after it has received the consent of the relevant competent authorities.

The Council's position forms one input into the trilogue negotiations between the European Council, the European Parliament and the European Commission, which is designed to reach agreement so that the proposed Regulation can pass through the plenary session of the European Parliament at first reading. The other input into the trilogue is the report to the Economic and Monetary Affairs Committee by Pascal Canfin, MEP, which was adopted on 7 March; a summary of the key points was provided in the [Second Quarter edition of this Newsletter](#).

At this stage, it is expected that, following a vote in the European Parliament in early July, the Regulation will be subject to further negotiations in trilogue on the basis of the Parliament's position. Once passed, the Regulation will enter into force on the day following that of its publication in the *Official Journal* and will be binding in its entirety and directly applicable in all Member States.

On short selling, the Chair of ESMA, Stephen Maijoor, had this to say at the ICMA Annual General Meeting in Paris:

“With regards to short selling, the Council's general approach adopted last week would implement for the first time the power assigned to ESMA in the ESMA Regulation to temporarily prohibit or restrict certain financial activities, in this case short selling and CDS transactions regarding sovereigns. The precondition for the use of this power is that the activity threatens the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system. We welcome this power that in my view is essential going forward to ensure that there is a mechanism in place at the European level to address situations with cross-border implications.

Whatever the final details of the Short Selling Regulation will be, it is important that the end result can avoid the possibility of regulatory arbitrage. For example, such a possibility could emerge if in one Member State short selling in a sovereign bond would be allowed, while short selling in that same sovereign bond, or sovereign bonds in a very similar situation, would be banned in other European markets. The financial markets in sovereign bonds are European, if not world-wide, and asymmetric treatment of similar situations would undermine the credibility of regulatory interventions. Further, it is important to avoid complex and unclear accountabilities. This would risk slowing down the decision making while a decision to ban will typically require speed to be effective.”

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## Secondary Market Rules: interest claims and settlement discipline

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At ICMA's Secondary Market Practices Committee in June, a group of members discussed proposed changes to the ICMA Secondary Market Rules and Recommendations to address two issues raised in the usage review: first, the variety of different practices in relation to interest claims in the market; and, second, the issue of settlement discipline and whether it was desirable or necessary to introduce formal settlement discipline measures. ICMA members are invited to join a working party to develop recommendations for a consistent method for calculating interest claims arising as a result of late trades and the introduction of settlement discipline, encouraging prompt settlement and discouraging late settlement. Measures to be considered include a market education programme to encourage market participants to take a consistent approach to interest claims and steps to encourage prompt allocation of trades among a manager's accounts. A Working Group has been established; further members are welcome.

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## Market structure

ICMA was asked to contribute to the work of a Study Group to revitalise the corporate bond markets in Japan. ICMA made a short presentation chiefly in relation to market structure and regulation, which was well received. The main points of the presentation are summarised here:

First, a market cannot exist without *demand and supply*. Supply comes from issuers, for whom a bond issue represents an attractive alternative to bank borrowing or equity finance (new issue or retained profits). Before 2008, it was fashionable in the West to retire equity (share buybacks) in favour of debt; this made corporate and bank balance sheets more fragile when the downturn came. Demand comes primarily from insurance companies and pension funds; these are typically “buy and hold” investors. A second group are retail investors, either directly or through bond funds. Shorter-term operators include hedge funds and – if markets are sufficiently automated and transparent – high frequency and algorithmic traders. Corporate treasurers (including bank treasurers) are another important group, including those involved in short-term secured operations (repo). Design of market structure must take account of the needs of all these groups.

Second, assuming the questions raised above can be answered satisfactorily, is the question of market structure. The broad choice is between a dealer market and an auction market; generally, bond markets are suited to the dealer model, though moves are underway in Europe (particularly France) to test whether continuous auction markets have a role to play. Early indications suggest a degree of scepticism, though this is usual at the early stages of an innovation to market structure. Dealer markets require dealers willing to commit capital; and this will be a function of the commercial opportunities offered by the market. Bond market transparency is a hot topic in Europe at the moment. It is important that the transparency regime is designed to optimise two aspects: investor confidence (that they can deal at, or close to, advertised prices and that sufficient aggregated information about completed trades is available) and dealer protection (that dealers have sufficient opportunity to re-balance their books without adverse price

movements as a result of early publication of a trade). Dealers are usually banks or specialised security dealers; to finance their inventory, dealers make extensive use of repo.

Third, robust *post-trading arrangements* are crucial. Central clearing is not widespread; it has been proposed by one of the experimental offerings referred to above, but it adds cost and operational complexity, in return for some additional security. Central clearing is also used in the repo market, particularly for term repo. Settlement must be cheap and efficient; these criteria are most likely to be met by a settlement house which can enjoy economies of scale and scope because it settles other securities. Safety and soundness of post trading arrangements are also essential and these are generally assured by licensing and oversight by the public authorities. Settlement houses must also comply with international standards (CPSS-IOSCO) and accounting and process control standards. Settlement between banks must be in central bank money.

Fourth, *macroprudential* regulation: the bond market is an important source of financing and a transmission mechanism for shocks; the authorities will therefore take a close interest in its structure, safety and soundness, robustness, and in its daily operations. Bond prices send important signals about investors’ views of the prospects for the economy and the likely future course of interest rates (yield curve).

Finally, *microprudential* regulation, conduct of business and investor protection all have a role to play. In addition to prudential supervision at the level of the firm, the authorities should seek to ensure that the bond markets are protected from abuse (price manipulation, abuse of unpublished information) and that market participants adhere to standards of business behaviour. In relation to investor protection it will be important to ensure that existing investor protection standards in relation to securities are applied and that due account is taken of the special characteristics of bonds (predictability of cash flows, probability of default) so that appropriately high standards do not unnecessarily restrict the development of a successful, deep and liquid bond market.

## Future of bond trading

ICMA’s Secondary Market Practices Committee, a body composed of a representative selection of ICMA member firms with a significant presence in the secondary debt markets, recently considered a paper on the long term future of secondary bond market trading in Europe. This

identified a number of emerging trends which would put current business models under pressure, together with some ways in which market participants might respond.

First, the paper makes some fundamental assumptions about the conditions for the market’s continued existence, namely: that corporates and banks will continue to see value in the financing opportunities offered by bonds; that investors will continue to follow mandates and strategies which can

be fulfilled and executed through the holding and trading of bonds; and that there will be a role for intermediaries in the trading of corporate bonds, either as a broker, finding counterparties, or as a dealer, acting as counterparty. The securities market is complementary to the bank lending channel of credit intermediation.

The future of secondary market bond trading will also be affected by current trends in the general economic environment, including low savings rates in the ageing Western economies, EU and US, needing to finance their banks, their government and their citizens' old age; profitable investment opportunities in young Asian economies that are attracting investors from elsewhere in the world; and the continuing need to finance the world's trade imbalances. These phenomena co-exist with the need and the opportunity to recycle domestic savings as productive investment.

Technical, regulatory and market developments in adjacent markets, such as swaps, foreign exchange, securities lending and repo will also affect the way bond markets function, as will the high-speed market automation that has become pervasive across asset classes, partly driven by the need to reduce error rates and technical progress in delivering extremely fast trading and automated post-trade processing in a controlled environment.

*Adverse trends:* For dealers, the capital committed to the trading book must earn a return consistent with expected returns for the group as a whole. At the margin, dealers will need to economise on the capital committed to the business if its price rises. The consequence for issuers is that bonds as an asset class become less liquid, or that liquidity is concentrated in a smaller range of bonds. Less liquid assets are subject to a return premium to take account of investors' increased risk; so the consequence is that bonds become a less attractive financing method compared to loans – other things being equal. But the reform of bank capital requirements implies that the pricing of bank credit will also be less attractive than hitherto – and it may be less readily available. From investors' point of view, while yields may rise, they will need to analyse and take account of a wider range of risks than they do at the moment, as they are being compensated for taking liquidity risk. Changes to bank capital requirements may also affect individual banks' willingness to remain in the dealing business.

In other markets, increased transparency has reduced dealers' profits – indeed, this effect is one which policymakers have identified as desirable in previous rounds of reform.

Other areas of reform – in Europe, in relation to market transparency, customer relationships, market infrastructure and securities law and in the US the rising tide of rule

making triggered by the wide-ranging Wall Street Reform and Consumer Protection Act (referred to as Dodd-Frank) – also reduce the attractiveness of the securities business to providers of capital.

*Mitigating factors:* The deployment of advanced technology, together with “offshoring” activities to less costly centres, has been a feature of European securities and derivatives markets for some years. Market automation has also played a significant role in reducing the unit cost of repetitive tasks. But some market participants are finding that they have reached or exceeded to frontier at which the benefits of offshoring outweigh the cost; and offshoring may not be economic for smaller market participants, given the need for economies of scale and scope in the establishment of offshore activities.

*Opportunities:* If some market participants depart from the dealing business, conventional theory predicts that the rewards reaped by those remaining are likely to be increased; though this effect may be outweighed by the increasing intensity of competition.

For providers of market infrastructure with the ability to reduce search costs, their services are more valuable in less liquid markets.

There may also be opportunities for issuers and investors in these rather different markets. For issuers, increased transparency will provide them with additional information about where comparable bonds are trading, allowing for more accurate pricing of new issues; for investors, reduced search costs and the application of trading tools to optimise trading performance may produce benefits comparable to those they have seen in other asset classes through which the waves of automation have already passed.

The interplay of the factors described here will likely result in significant changes to the bond trading landscape. Furthermore not all sectors of the fixed income markets will be affected in the same way. In some sectors these factors will combine to provide well-functioning primary and secondary markets, with profitable trading opportunities; in others, these and other factors could operate so as to damage the functioning of the markets and to provide corresponding opportunities for lending bankers.

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## Covered bonds

The Covered Bond Investor Council (CBIC) held several meetings on the level of disclosure of covered bonds' cover pool. The Council noted that there was no level playing field in Europe in this regard. Although this was a long-standing complaint of investors, the CBIC finally formulated *A Coherent List of Disclosure Requirements that would be Requested from Issuers*. The list included data as well as explanations of complex concepts and calculation methods. It also showed that covered bonds contained an important credit element in them which needs to be analysed. A public consultation was launched in the course of April for a period of two months. However the document would not request a loan-by-loan data set as does the Bank of England.

ICMA has received preliminary positive feedback both from investors and national issuers' associations. The CBIC will be publishing a feedback statement in the course of July on our webpage.

HM Treasury and the FSA published *A Joint Review of the UK's Covered Bond Regulation*. The review proposes a number of measures that seek to build upon the UK's existing covered bond regime. These measures aim to ensure that the UK covered bond market is better aligned with markets in other countries, enabling UK issuers of covered bonds to compete on a more level playing field.

The review also provides an update on the UK's engagement with international partners on broader policies concerning covered bonds. In particular, the UK believes that in the exercise of any future "bail-in" powers, secured creditors' rights to collateral should not be over-ridden. The CBIC [responded](#) to the consultation.

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## Shadow banking

In April, the Financial Stability Board (FSB) published [its note on shadow banking](#). The FSB released the note following the commitment made by the G20 at the Seoul November Summit to look at shadow banking. It is broadly described as credit intermediation involving entities and activities outside the regular banking system. The note recognises the advantages of shadow banking, for instance the fact that it

provides market participants and corporates with alternative sources of funding and liquidity, but is also a source of systemic risk.

The report considers three main themes:

- clarifying what is meant by "the shadow banking system";
- setting out potential approaches for monitoring the shadow banking system;
- exploring possible regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking system.

The [Asset Management and Investors Council \(AMIC\) responded](#) explaining it believed that a key step in the "shadow banking" discussion was to clarify the type of activities understood under the term "shadow banking". Moreover the AMIC wanted to ensure that recommendations of regulatory reforms take into account the current regulatory developments and their impact on the asset management industry; and avoid regulatory overlaps. The Council also recommended a global approach in the definition and identification of shadow banking issues.

The FSB will consider initial recommendations at its July plenary meeting and submit its final recommendation at the G20 autumn meeting.

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## Exchange-traded funds

The AMIC has set up a Working Group to discuss issues related to exchange-traded funds (ETFs). Investors' motivations for using ETFs have expanded and are no longer limited to cost advantage and broad market access concern. Although initially investors mainly used ETFs for managing asset allocation and increasing diversification (for which the simpler "early version" ETFs were entirely adequate), they are now seeking to use ETFs to take tactical positions, including negative positions in asset classes, either to remove existing unwanted exposure or to express a negative view. In all of this investors are utilising the essential characteristics of ETFs: their intra-day liquidity and enhanced flexibility, allowing investors to take both long and short positions. ETFs have been embraced because in a back-to-basics' environment, they provide transparency, simplicity, liquidity and other favourable features. The increase in usage, breadth and

product flexibility has driven a steady growth in the use of ETFs over the past decade. This expansion has been fuelled by the increase in the range of asset classes accessible through ETFs. Moreover, the introduction of ETFs covering emerging markets, commodities and property has allowed investors to access some of the performing asset classes of the past few years. On top of greater asset breadth, the range of instruments has also grown.

The AMIC ETF Working Group believes that it is important for investors to understand there are various forms of exchange-traded products (ETPs) which tend to be loosely defined as “ETFs”. The ETP industry needs to educate investors and be clearer on the labelling of various ETPs. The main areas of complexity and opacity relate to instruments often confused with ETFs – these are ETNs, ETCs and ETVs.

The FSB and other regulators published reports on the evolution of the ETF market. [AMIC responded](#) to the [FSB Note on ETFs](#).

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## Corporate governance

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EFAMA has published its *Code for External Governance*. This contains a framework of high-level principles and best practice recommendations to assist investment management companies engage with the companies in which they invest. The principles are aimed at improving the quality of the communication with investee companies and to foster creation of value to investors by dealing effectively with concerns over a company’s performance. The Code is available [here](#).

The European Commission has published its *Green Paper entitled The EU Corporate Governance Framework*.

The Commission recognised the importance of the Green Paper on corporate governance in financial institutions and remuneration policies adopted in June 2010, but explained that the solutions envisaged in the June 2010 Green Paper may not be relevant to EU companies in general. Accordingly, this Green Paper addresses the following three topics:

- the board of directors;
- shareholders – and shareholders’ engagement with management;
- how to apply the “comply or explain” approach which underpins the EU corporate governance framework.

The AMIC Corporate Governance Working Group will be responding to the Green Paper. We understand that legislative proposals following the first Commission Green Paper on corporate governance in financial institutions will be published shortly.

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## AIFM Directive

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The AIFMD is considered at European Securities and Markets Authority (ESMA) as part of the Level 2 legislative process which looks at the implementation measures. It was expected that ESMA would issue technical guidance. ESMA has broken down its work into four working groups:

- Depositories – chaired by the AMF, France.
- Scope and types of AIFM – chaired by the Central Bank of Ireland.
- Authorisation/delegation/organisational requirements – chaired by BAFIN, Germany.
- Transparency/leverage/risk/liquidity – chaired by the FSA, UK.

At the last AMIC meeting it was concluded that, although Level 1 had been agreed, there were still a lot of issues to be resolved, notably the fact that there was a need for directives rather than regulation in this space. It is expected that ESMA will be publishing a Level 2 consultation paper in the course of July.

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## Regulation of the market infrastructure

### Expert Group on Market Infrastructures (EGMI)

The fourth meeting of the European Commission's [Expert Group on Market Infrastructures \(EGMI\)](#), in which the ICMA participates as an observer, took place on 28 April. In this meeting there was a discussion concerning an idea for radical future infrastructure developments in the securities industry; and the Group discussed the possible structure of its forthcoming report and various options for presenting it.

The Group decided that it would work on three alternative scenarios:

- small incremental step scenario (eg update of the Giovannini process);
- more ambitious (eg going beyond the Giovannini barriers); and
- ambitious and visionary.

Work on the Group's report is ongoing, with a further EGMI meeting held on 22 June to discuss and develop thoughts on these scenarios. A conference related to EGMI's work is now planned for 24 October.

### European Market Infrastructure Regulation (EMIR)

Published on 15 September, the Commission's EMIR proposal is a Regulation on [OTC Derivatives, Central Counterparties and Trade Repositories](#). Following the standard co-decision procedure, both the Council and the European Parliament have been working to determine their positions in respect of this proposal. The aim is that, in line with G20 commitments, the new rules should be fully in place and operational by the end of 2012.

On 24 May, the EP's Economic Affairs Committee (ECON) announced a ["clampdown on derivatives trading"](#), following its virtually unanimous agreement to [the amended report](#) produced by its rapporteur, Werner Langen. This envisages a strong supervisory role for ESMA; reporting obligations to cover all derivatives, whilst otherwise only applying to regulate OTC derivatives; a special regime for pension funds; CCP interoperability for cash securities only; and no retrospective application, save possibly in case of reporting obligations.

This report was debated by the full European Parliament on 4 July; and then adopted by a show of hands in its 5 July plenary meeting. A formal final vote was postponed, with this plenary vote only being used to evidence a significant majority to strengthen the hand of MEP negotiators. Similar issues are also under consideration in the applicable Council Working Group and permanent representatives' meetings, where the Hungarian Presidency has presented a series of compromise texts; and were debated in the 20 June ECOFIN meeting, as reported on page 9 of [the related conclusions](#).

### TARGET2 - Securities (T2S)

At the start of May a new issue of T2S OnLine ([No 8, Spring 2011](#)) has been published by the ECB. This issue is dedicated to the T2S User Detailed Functional Specifications (UDFS) version 1.0 that has been [published for market consultation](#). In his editorial, Jean-Michel Godeffroy, the Chairman of the T2S Programme Board, invites review of the UDFS and the provision of comments by 27 May. In *Bayle's View*, Marc Bayle (T2S Programme Manager) explains why the UDFS is of key importance and why it should be promptly reviewed. This issue also includes two insight articles – a round-table interview asking the people behind the UDFS about their experiences; and an article by Stephanie Duverger (of the T2S Programme Office) covering all you need to know about ISO 20022 messages in T2S. Finally, there is an introduction to the 4CB team behind the UDFS.

A T2S info session was [held on 31 March](#) in Cyprus and another was held in Zurich on 12 July. 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 30 June-1 July (and next meets on 28-29 September) for its latest progress review.

The T2S Harmonisation Steering Group (HSG) has been established to support the AG. In its 7 March meeting, the AG mandated the HSG to:

- analyse the list of T2S harmonisation items;
- assess and follow the implementation of the T2S harmonisation agreements and standards in domestic markets in liaising with the T2S National User Groups (NUGs);
- present a status update of the HSG work in each AG meeting and seek advice where necessary;
- advise the AG to undertake initiatives for communicating key harmonisation policy issues to the relevant EU authorities; and
- deliver a progress report to the AG on a semi-annual basis.



The mandate of the HSG is linked to the efficient launch of T2S and is therefore limited until September 2014.

## ECB Report on Settlement Fails in SSS

On 12 April, the ECB published *Settlement Fails – Report On Securities Settlement Systems (SSS) Measures To Ensure Timely Settlement*. This publication draws on Eurosystem expertise on the topic, and on a survey about measures to enhance settlement efficiency (already) adopted by SSSs in the European Union. This publication is meant as an informative brochure:

- to provide background information about fails, their possible causes and what the consequences are for the parties involved (Section 1); and
- to describe the main measures actually in place to prevent, discourage and mitigate the effect of fails (Sections 3, 4 and 5).

Section 2 addresses various aspects related to the level and duration of settlement fails. In this respect, it is emphasised that currently no uniform methodology and data availability for the experience of EU SSSs with respect to settlement fails exists, which makes it difficult to draw meaningful conclusions that are comparable amongst the European SSSs.

## ECB Money Market Contact Group

On 1 June, the ECB hosted the latest meeting of its Money Market Contact Group (MMCG). As well as a review of recent market developments, discussions in this meeting concerned the role and the impact of CCPs in the repo market. To provide context for this there was (i) a presentation on the general role of CCPs by the ECB and (ii) two presentations by major CCPs (LCH.Clearnet and Eurex Clearing) on their respective risk management practices. The next meeting is scheduled for 5 September.

## ECB Contact Group on Euro Securities Infrastructures

On 18 May, the ECB hosted the latest meeting of its contact group on euro securities infrastructures (COGESI). Discussions in this meeting covered many issues impacting the repo markets, including ICSD interoperability for triparty repo which was reviewed in detail. This latter topic is of particular significance to the ERC, which continues to be actively engaged in ongoing discussions around access to the infrastructure – with a particular focus on elimination of the current barriers to the achievement of a single liquidity pool.

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## Legal framework for securities holding and dispositions

We reported in the *First Quarter 2011 Newsletter* that the Commission services had launched a public consultation on the *Harmonisation of the Legal Framework for Securities Holding and Dispositions*. EU Member State laws on the holding and disposition of securities differ considerably which could lead to legal uncertainty in cross-border situations. The Commission received 108 responses (including a response from ICMA on behalf of its primary market constituency and the European Repo Council) and published an extended summary of responses.

The European Parliament's Directorate General for Internal Policies Policy Department A: Economic and Scientific Policy has now published a briefing paper on *Cross-Border Issues of Securities Law: European Efforts to Support Securities Markets with a Coherent Legal Framework*. The paper describes the trust model (used in England and Wales), the security entitlement model (used in the US and Canada), the undivided property model (used in France), the pooled property model (used in Germany, Austria and Japan), the transparent model (used in Greece, Poland and the Nordic countries while China and Brazil use variants of this model). The paper notes that early discussions did not entirely identify these models and instead reference was made to "direct"

and “indirect” models – ie whether the investor had a legal link to his securities or only a right against his intermediary. The paper recommends that the notions of “direct” and indirect” be set aside as being too vague.

The paper also examines cross-jurisdictional situations and explains how domestic laws may influence various parts of a cross-border securities holding chain. However, because different jurisdictions can use different models (as described above), it may be difficult easily to identify who has rights over the securities, resulting in considerable legal uncertainty, which can take considerable amounts of time to resolve.

The paper also highlights the need for a clear legal framework for securities holding and disposition in relation to the provision of collateral. While the Financial Collateral Directive sets out

rules about how collateral is validly established and provided to the collateral taker, there is no common framework on what happens if something goes wrong, such as validly provided collateral being the subject of a priority contest between two collateral takers. In this regard, legal uncertainty is particularly problematic for central counterparties (CCPs). If collateral is legally uncertain in times of financial turmoil, the CCP cannot fulfil its function and the protections it is supposed to provide would be limited. Finally, the paper summarises the Commission’s recent consultation paper and outlines some of the policy areas where respondents to the consultation expressed support.

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Steven Maijoor, Chairman of ESMA, delivering the keynote address at ICMA's Paris AGM and Conference

## ICMA AGM and Conference 2011

The recent ICMA AGM and Conference held in Paris at the end of May was attended by over 700 delegates from banks, financial institutions, regulatory authorities and law firms from all around the world. More than 30 sponsors and exhibitors supported the event at the Marriott Rive Gauche, which ran over two days with a full agenda of panels and speakers on varied capital market themes.

Webcasts of the panel discussions and also the keynote speeches at the conference, made by Steven Maijor, Chairman, European Securities and Markets Authority, Jaime Caruana, General Manager, Bank for International Settlements; Dr Thomas Mayer, Chief Economist, Deutsche Bank Group; and Jean-Pierre Jouyet, Chairman, Autorité des Marchés Financiers, are available from the [ICMA website](#).

The 2012 ICMA AGM and Conference will be held in Milan from 23 to 25 May. For sponsorship opportunities, please contact the [ICMA Events team](#).

## ICMA events

### Understanding the ICMA Primary Market Handbook

London, 8 September

London, 8 December

These [half-day workshops](#) on ICMA's Primary Market Handbook for the issuance of international debt and debt-related instruments will give an overview of the scope and application of the recommendations and also take in recent developments and changes.

The workshops are open to ICMA members at a discounted rate and to non-members.

*Understanding the ICMA Handbook is an accredited workshop under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. Solicitors may claim 2.5 hours CPD credit for their attendance at this workshop.*

[Register here](#)

### The Global Master Repurchase Agreement (GMRA) 2011 – roundtable briefings for ICMA members

Dublin, 12 September

Vienna, 14 September

Madrid, 18 October

The 2011 version of the GMRA, the most widely used standard documentation for the cross-border repo market, has recently been published by ICMA, together with the associated legal opinions for 2011. The GMRA 2011 is the result of a market-driven process and wide consultation; it represents over a year's worth of detailed discussion and debate involving market participants and legal specialists.

The briefings on the GMRA 2011, which are free and open to ICMA members only, will be led by Lisa Cleary, ICMA Associate Counsel and Godfried De Vidts, Chair of ICMA's European Repo Committee.

[Register here](#)

### ICMA European Repo Council meeting,

Paris, 14 September

The next ICMA European Repo Council (ERC) meeting will be held in Paris on Wednesday 14 September.

The agenda for the meeting features a keynote speech by Gertrude Tumpel-Gugerell, former member of the Executive Board of the European Central Bank on the theme: *Eight Years of Support to Integrate Europe's Post-Trading*. There will also be an update on the GMRA 2011 and on other market practice and regulatory issues.

The event is free of charge and open to all within the repo community.

[Register here](#)

## Global Master Agreements for Repo and Securities Lending Workshop

Zurich, 21-23 September

Amsterdam, 23-25 November

The Global Master Repurchase Agreement (GMRA) and the Global Master Securities Lending Agreement (GMSLA) are the essential legal underpinnings of the closely-related repo and securities lending markets. The [three-day workshop](#) will include a detailed review of each agreement, consider common legal issues, and highlight the growing similarities and remaining differences. There is a strong practical aspect to the workshop and the application of the agreements will be discussed and illustrated with case studies. And in order to ensure a clear understanding of what is being documented, the workshop begins by explaining the operational and basic legal characteristics of the instruments and their markets. The workshop will include the newly published GMRA 2011.

*The Global Master Agreements for Repo and Securities Lending Workshop is an accredited course under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme. Solicitors may claim 18 hours CPD credit for their attendance on the whole course.*

[Register here](#)

## ICMA European Repo Council 2011 Professional Repo and Collateral Management Course

London, 21-22 November

This annual course has been run in locations throughout Europe successfully for almost ten years. It has been completely revised and updated to include the impact of the crisis on the repo market and the latest developments in clearing and settlement. Its unique mix of presentations by experienced practitioners, who are actively involved in the repo market on day to day basis, and a sound theoretical explanation of the principles involved in this type of financing from ICMA Centre academics make it the market benchmark for all professionals starting out in the repo market.

The 2011 Professional Repo and Collateral Management Course will be sponsored by BondLend.

[Register here](#)

## ICMA Centre turns 20

The University of Reading's ICMA Centre has just celebrated 20 years of providing high-quality education for the financial markets. The occasion was marked by a reception at the Centre for staff past and present and for alumni.

Now part of Henley Business School, the ICMA Centre was established in 1991 with funding from ICMA. The Centre has come a long way in twenty years and now runs an impressive range of Undergraduate and Master's Programmes, a PhD programme, research, consultancy and executive education programmes, for around 400 students each year. It has recently become part of the large and very successful Henley Business School.

ICMA and the ICMA Centre have been long-term partners in the development of a range of internationally recognised, education programmes for financial market professionals.

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## ICMA Executive Education Skills Course

### Successful Sales, London 15-16 September

This two day sales and marketing training course is specifically designed for capital market professionals. The focus will be on acquiring sales skills for selling debt, equity and derivative instruments to an institutional client base. It aims to develop market-leading client acquisition and retention skills. The course covers both core telephone selling skills and client meeting skills.

[Register here](#)

## Summary of forthcoming ICMA Executive Education courses

ICMA has launched two Diplomas, focusing on either Securities and Derivatives or Financial Market Operations. Each Diploma can be achieved by successfully completing one introductory programme, one intermediate programme and two specialist programmes from the relevant Diploma pathway.

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### Introductory programmes

**Financial Markets Foundation Course (FMFC)**

26-28 September 2011, Luxembourg

21-23 November 2011, London

5-7 March 2012, Luxembourg

**Securities Operations Foundation Course (SOFC)**

11-13 October 2011, London

30 January – 1 February 2011, London

### Intermediate programmes

**International Fixed Income and Derivatives (IFID)**

**Certificate Programme**

21-27 August 2011, Seoul, South Korea

16-22 October 2011, Sitges, Barcelona

22-28 April 2012, Sitges, Barcelona

**Operations Certificate Programme (OCP)**

25-31 March 2012, Brussels

**Primary Market Certificate (PMC)**

14-18 November 2011, London

14-18 May 2012, London

### Specialist programmes

**Collateral Management**

3-4 October 2011, London

**Corporate Actions – An Introduction**

24-25 October 2011, London

**Credit Default Swaps (CDS) – An Introduction**

26 September 2011, London

**Credit Default Swaps (CDS) – Operations**

27 September 2011, London

**Global Custody**

8-9 November 2011, Geneva

**Securities Lending & Borrowing**

14-15 November, London

**Technical Analysis and Inter-Market Trading**

13-14 September 2011, Brussels

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

Please e-mail:

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or alternatively the ICMA contact whose e-mail address is given at the end of the relevant article.

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