ICMA
International Capital Market Association

QUARTERLY REPORT

ASSESSMENT OF MARKET PRACTICE AND REGULATORY POLICY

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BREXIT: ADDRESSING RISKS IN INTERNATIONAL CAPITAL MARKETS

IMPLEMENTATION OF MIFID II/R

BAIL-IN VERSUS BAIL-OUT

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ICMA

International Capital Market Association

ICMA promotes resilient and well-functioning international capital markets, which are necessary for economic growth. ICMA's market conventions and standards have been the pillars of the international debt market for nearly fifty years.

Membership continues to grow and we now have more than 500 member firms in some 60 countries. Around 80% of our members are based in Europe.

Among the members are global investment banks, commercial and regional banks, brokers, private banks, institutional asset managers, pension funds, central banks, sovereign wealth funds and other institutions with a significant interest in the international capital market, such as supranational institutions, infrastructure providers, rating agencies and leading law firms.

ICMA members work with ICMA through its market practice and regulatory policy committees and councils to provide expert views on the issues affecting the international capital markets. The committees act as a forum for discussion and for reaching consensus on topics of common interest, developing recommendations for best market practice and the efficient operation of the markets and considering policy responses to regulators.

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By Martin Scheck

In Europe, the political landscape has been the main focus for many capital market participants with the French election results seen as positive for the EU, and the UK election results leading to even greater uncertainty as to the outcome of the negotiations on Brexit. The Quarterly Assessment written by Paul Richards in this ICMA Quarterly Report draws attention to five key risks arising from Brexit for the international capital markets. Negotiations between the UK and the EU 27 have now started, but the picture remains unclear and the final impact on the market will not be apparent for some time to come.

In the last Quarterly Report, I commented that we were waiting to see how the new US Administration would operate. It has been interesting to see the move to soften aspects of Dodd-Frank, and of course disappointing to see the US pulling out of the COP 21 Paris Agreement.

At ICMA we run the Secretariat of the Green Bond Principles which are widely followed globally, and have been highly influential in helping the green bond market develop. We do this because we believe that the capital markets have a critical role to play in funding projects that can contribute to environmental sustainability and we are committed to doing our bit. Political leadership is fundamental, it is important all nations pull together to address environmental sustainability and the signals sent out by world leaders do matter. So, it is very disturbing to see the latest political developments and it makes it even more important that we mobilise all the tools we have at our disposal to achieve the objectives, including of course the capital markets.

We were pleased to launch an updated version of the Green Bond Principles and for the first time Social Bond Principles following a similar "use of proceeds concept", and Sustainability Bond Guidelines, at the recent AGM and Conference of the Green Bond Principles in Paris. This attracted tremendous interest and a record attendance. We are very hopeful that the Principles will contribute to continued growth in the green and social bond markets. We are also continuing our work on developing the green bond market in other geographical areas such as Asia, and working with regional and national regulators to ensure that where regulation is being introduced it is aligned with the Green Bond Principles to the greatest extent possible.

You may have seen that we have recently published a research study on the state of the credit repo markets (*European Credit Repo Market: The Cornerstone of Corporate Bond Market Liquidity*). It concludes that this market appears to be functioning reasonably well – but nevertheless we remain vigilant since both the CSDR mandatory buy-in regime and the implementation of the NSFR threaten to erode its ability to function.

We continue our endeavours to help members with the implementation of MiFID II and MiFIR (MiFID II/R). This impacts almost all of our members, and whilst it is European legislation it has implications also for members outside Europe. The work is indeed intensive, whether on primary markets, secondary markets, repo or the buy side and the scope of MiFID II/R is extremely broad. We have a resource centre for MiFID II/R on the website with links to ICMA's (and others') briefing papers and responses to consultations. There remains much to clarify and resolve, and we will be issuing a regular ICMA MiFID II/R briefing publication for members containing the latest developments. In addition we have organised a series of MiFID II/R briefing events in a number of European financial centres starting with London in July. Let me take this opportunitiy to remind members of the existence of the Legal and Regulatory Helpdesk – a very useful and well-used central resource to help answer members' questions.

ICMA in Asia-Pacific continues to focus on primary markets, repo, and green bonds, while pursuing new initiatives on secondary markets and electronic trading in the region. The Asia Bond Syndicate Forum and the Asia Legal and Documentation Forum continue market-leading discussion of topics of regional interest such as X-accounts, electronic trading, allocations, and retail distribution. In China, ICMA is now recognised by local policy makers as the authoritative international trade association in primary markets and green bonds. In the Asian repo markets, ICMA is driving the extension of the ERCC survey to the region and continues to promote the continued development of repo documentation and practices in southeast Asia. Also, in cooperation with the Secondary Market Practices Committee, we have started research to expand ICMA's studies on corporate bond liquidity and our work on electronic bond trading to cover the Asia-Pacific markets.

As a final comment, it was wonderful to see so many of you at the ICMA AGM and Conference in Luxembourg in May. Next year's AGM and Conference – our 50th – will be in Madrid on 30 May to 1 June 2018.

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Brexit: addressing risks in international capital markets

By Paul Richards

Summary

In preparing for Brexit[1], a great deal of work is already being done by financial institutions on contingency planning.[2] Apart from the preparations needed by financial institutions, there are also risks in international capital markets arising from Brexit that need to be addressed because of their potential impact on capital market integration and on financial stability. The key risks relate to: shortage of time; legal uncertainty; restricted access to markets and skills; cross-border regulatory divergence; and a "cliff edge" on Brexit. The purpose of this Quarterly Assessment is to examine these risks, and assess what can be done to keep them to the minimum, both from a UK and an EU27 perspective, so as to prevent capital market fragmentation and ensure that financial stability is maintained.[3]

Introduction

1 After the UK Referendum on 23 June 2016, in which the UK voted by 52% to 48% to leave the EU rather than remain, the Prime Minister set out the British Government's objectives in a speech at Lancaster House in January 2017 and in a subsequent White Paper.[4] The Government's objectives involve taking back control of the UK's borders by limiting EU immigration to the UK, and taking back control of UK laws by bringing an end in the UK to the jurisdiction of the European Court of Justice. As these objectives are not consistent with remaining in the EU Single Market, the British Government proposes to leave the Single Market when it leaves the EU.[5] Instead, the Government wants to negotiate "the greatest possible access" to the EU Single Market through an "ambitious free trade agreement" with the EU as a third country.

2 Following Parliamentary consent, the Prime Minister wrote to the President of the European Council on 29 March in order to invoke Article 50 of the Treaty of European Union and enable the UK and the EU27 to start the process of negotiating UK withdrawal from the EU. Article 50 is due to expire on 29 March 2019. The European Commission's negotiating guidelines were set by the European Council at a Summit on 29 April.[6]

3 On 18 April, the Prime Minister unexpectedly called a General Election in the UK for 8 June with the objective of achieving for the Conservative Party a larger overall majority in the House of Commons than before. The result of the election on 8 June was that, while the Conservative Party remained the largest party in the House of Commons, it failed to achieve an overall majority. The full implications are not yet clear, but:

1. ie the withdrawal of the UK from the EU.

2. Shortly after Article 50 was invoked, the Prudential Regulation Authority in the UK asked all banks, insurers and designated investment firms undertaking cross-border activities between the UK and the rest of the EU (ie the EU27) to submit their plans by 14 July. The Financial Conduct Authority also wrote to the largest asset managers.

3. The paper does not assess other risks arising from Brexit, such as the risks for the UK and EU27 economies, interest rates and exchange rates. Nor does it consider the impact on the politics of euro-area integration.

4. The Prime Minister: *The Government's Negotiating Objectives for Exiting the EU:* Lancaster House, 17 January 2017. The British Government White Paper (Cm 9417) was published in February 2017.

5. Within the EU Single Market, the "single passport" allows financial services operators legally established in one EU Member State to establish or provide their services in the other Member States without further authorisation requirements.

6. *European Council (Art. 50) Guidelines Following the UK's Notification under Article 50 TEU*: 29 April 2017 ("European Council guidelines").

- it is likely to be more difficult in the new Parliament for the Government to pass the large amount of legislation needed in the UK to enact Brexit in time before Article 50 expires on 29 March 2019, without cross-party support;
- there is expected to be a greater focus in the new Parliament on the potential impact of the Government's approach to Brexit on UK growth and jobs; and
- the risk that the UK and the EU27 will fail to reach agreement before Article 50 expires appears to be at least as great as before.

4 The negotiations between the British Government and the European Commission on behalf of the EU27 began on 19 June. Both sides confirmed that the UK will leave the EU Single Market when it leaves the EU.[7] That is the working assumption in this Quarterly Assessment. An alternative for the UK when it leaves the EU would be to remain in the Single Market by joining the European Economic Area, if necessary temporarily so that Brexit takes place in two stages rather than one.[8]

The risk of shortage of time

5 The first key risk in international capital markets arising from Brexit is shortage of time to make the necessary preparations, taking account of uncertainty about the outcome of the negotiations between the UK and the EU27, for four main reasons:

- First, it is not expected that Article 50 will be extended when it expires on 29 March 2019, two years after it was invoked, because the EU27 want the UK to leave the EU before the European Parliament elections in 2019, and any extension would require unanimity among the EU27. So far, the British Government has indicated that it does not want to extend Article 50 in any case.
- Second, the timetable for the Article 50 negotiations is in practice shorter than two years. After Article 50 was invoked, the first three months elapsed before negotiations between the UK and the EU27 began on 19 June; and around six months is likely to be needed at the end of the process to provide time for ratification by the British Parliament, the European Parliament and the EU Member States. That leaves only around 15 months for the negotiations themselves, during which Parliamentary elections are also due to take place in Germany and Italy.
- Third, the Article 50 negotiations are due to cover the withdrawal terms,[9] taking account of the framework for relations between the UK and the EU27 in future. The European Council guidelines set out two phases for the negotiations:[10] the first phase for the withdrawal terms; and the second phase for the framework for the EU's future relations with the UK. "Sufficient progress" needs to be made on withdrawal terms before the framework for a new trade agreement can be negotiated.[11] As the UK and EU27 positions appear to be far apart on the terms of a financial settlement for UK withdrawal, this could reduce the time available to negotiate the framework for a new trade agreement before Article 50 expires.
- Fourth, for the capital markets, the Brexit timetable is complicated by the provision in the European Council guidelines that negotiations under Article 50 will be conducted as a single package, under which "nothing is agreed until everything is agreed".

6 There is also a risk that the negotiations will fail, either because the two sides fail to agree or because they fail to ratify the agreement in time. This may be for reasons unrelated to financial services, which represent only part of the overall negotiation package.

- In the case of the EU27, the withdrawal agreement is concluded by the Council on the basis of a super-qualified majority: 72% of members, comprising at least 65% of the population: ie at least 20 out of the 27 EU Member States (excluding the UK), plus a simple majority in the European Parliament.
- In the case of the UK, Parliament is to be given a vote on the terms negotiated by the British Government before the expiry of Article 50. But if Parliament does not agree with the terms, the UK will leave the EU without an agreement, unless either: (i) the terms can be improved

7. They also confirmed that the UK would leave the Customs Union, though the Chancellor of the Exchequer said that "we will almost certainly need an implementation period, outside the Customs Union itself, but with current customs border arrangements remaining in place, until new long-term arrangements are up and running.": Mansion House speech, 20 June 2017.

8. A more fundamental alternative would be for the UK to stay in the EU but remain outside the euro area under the terms negotiated by the British Government with the EU27 in February 2016. As this approach was rejected in the UK Referendum in June 2016, it could not in practice be reversed without another referendum in the UK. It also assumes that Article 50 could be revoked.

9. The withdrawal negotiations are intended to settle, *inter alia*: UK contributions to the EU budget; acquired rights of UK citizens in the EU27 and EU27 citizens in the UK; and the relocation of EU agencies, including the EBA, from the UK to the EU27.

10. The British Government originally argued that the two phases should be negotiated together at the same time. But it may now take advantage of the first phase to consider its approach to the second phase in more detail.

11. Chancellor Merkel said in the Bundestag on 27 April 2017: "We can only do an agreement on the future relationship with Britain when all questions about its exit have been cleared up satisfactorily."

in the remaining time before Article 50 expires; or (ii) Article 50 is revoked (eg on the grounds that the British Government's intentions have changed). The revocability of Article 50 has not been tested in the Courts.[12] This would be a matter for the European Court of Justice. If Article 50 can be revoked, there is a question whether a change in the British Government's intentions would be sufficient to revoke it, or whether EU27 agreement would also be required, and if so on what basis.[13]

The negotiation of a new trade agreement

Given the shortage of time, it is not expected to be possible to complete the negotiation of a new trade agreement between the UK and the EU27 before Brexit. For example, the trade agreement between the EU and Canada took seven years. As in the case of the trade agreement between the EU and Canada, if the trade agreement between the UK and the EU27 were to be classed as a "mixed" agreement (ie involving both EU and national competences), this would be likely to require unanimity in the EU27, involving votes in 38 national and regional Parliaments. However, in the case of the trade agreement between the EU and Singapore (completed in September 2014), the European Court of Justice ruled on 16 May 2017 that the EU had exclusive competence – requiring only a qualified majority – in all but two aspects of the agreement,[14] and only these two aspects of the agreement would require unanimity among EU Member States. This suggests that a free trade agreement between the UK and the EU27 would be easier to ratify if it was, at least initially, limited in scope to provisions subject to qualified majority voting.[15]

The risk of legal uncertainty

7 Legal uncertainty is the second key risk in capital markets arising from Brexit. The European Council guidelines recognise that the first phase of negotiations should aim to "provide as much clarity and legal certainty as possible" about the immediate effect of the UK's withdrawal from the EU, and that the "negotiations should seek to prevent a legal vacuum once the Treaties cease to apply to the UK and to the extent possible reduce uncertainties".

8 The British Government is planning to address legal uncertainty about Brexit in two ways:

- first of all, by accepting that EU law will continue to apply in the UK until the UK leaves the EU, including new EU legislation between now and then (like MiFID II/R, which is due to be implemented on 3 January 2018);
- second, by introducing the Great Repeal Bill, which is intended to take EU law into UK law on the day on which the UK leaves the EU (ie Brexit), with any changes taking place subsequently. A British Government White Paper setting out the aims of the Repeal Bill was published on 30 March. It is already clear that the Repeal Bill cannot just be a "copy and paste" exercise. For example, references to EU institutions need to be replaced by UK institutions. (The EU27 may also need to adjust EU financial legislation to take account of the exclusion of the UK.) The outcome of the General Election in the UK is likely to make the passage of the Repeal Bill – and the other Brexit-related Parliamentary Bills required – more difficult rather than less, without cross-party support.

9 In order to avoid legal uncertainty in the capital markets over Brexit, one of the key issues that needs to be addressed is how to ensure continuity of cross-border financial contracts between market participants in the UK and the EU27 written before Brexit but which mature afterwards.[16] Where these contracts provide for the performance of financial services over a period of time including Brexit, it is important that Brexit does not create any legal uncertainty among market participants about continuing to provide them, even if the regulatory arrangements on which they are based change in the meantime: eg if passporting between the UK and the EU27 is no longer available after Brexit. One possible way of guaranteeing continuity of contracts between UK and EU27 market participants would be to provide for the "grandfathering" of existing contracts outstanding at Brexit in the UK/EU27 withdrawal agreement.[17]

12. The Supreme Court judgment in the Miller case on 24 January 2017 did not directly address whether Article 50 *could* be revoked, as both sides agreed that, once Article 50 was invoked, it *would not* be revoked.

13. The French and German Governments and the European Commission have indicated that the UK might be given the opportunity to remain in the EU, if it wished, possibly until the point at which it leaves.

14. These two areas relate to indirect foreign investment and investor-state dispute settlement mechanisms.

15. See Clifford Chance: *What Does the Singapore FTA Decision Mean for the EU's FTAs and Brexit?* May 2017.

16. There are other issues relating to new contracts: eg uncertainty over the extent to which the authorities in the EU27 will continue to allow English law to be used in new international contracts involving the EU27 in future, or will insist instead on the law of an EU27 Member State.

17. See Freshfields Bruckhaus Deringer: *The Legal Impact of Brexit on the UK-based Financial Services Sector:* May 2017.

The risk of restricted access to markets and skills

10 The third risk is that access to markets and skills is restricted as a result of Brexit. This risk arises because the British Government has stated that the UK will leave the EU Single Market when it leaves the EU and proposes instead to negotiate a new free trade agreement with the EU27.[18] The Government accepts that, after Brexit, the UK will trade with the EU27 on rules set by the EU27 without any direct UK involvement in future (as in the case of other markets around the world).[19]

(i) Regulatory equivalence between the UK and the EU27

11 Under a free trade agreement between the UK and the EU27, it needs to be clear to what extent capital market firms will be able to rely on mutual recognition of regulatory equivalence between the UK and the EU27 after Brexit to obtain market access, both from the UK to the EU27 and vice versa. The current arrangements for regulatory equivalence represent a patchwork of equivalence, endorsement, recognition and third country passporting.[20] There are provisions for determining equivalence in some EU regulations but not others and, where equivalence does apply, it is not always complete; determining equivalence involves a judgment by the European Commission as well as a technical assessment, and takes time; and the determination of equivalence can be withdrawn at short notice, though this has not happened to date.[21]

12 The current patchwork of regulatory equivalence has clearly not so far evolved with Brexit in mind. But on Brexit, capital market regulations in the UK and the EU27 will be the same. Consequently, the negotiation of a free trade agreement between the UK and the EU27 would provide the opportunity to establish mutual recognition of each other's regulatory regime. However, this would also mean that UK and EU27 regulations would need to continue to be consistent in future after Brexit; and the free trade agreement would also depend on setting up appropriate mechanisms for enforcing the agreement and settling any disputes.[22]

(ii) Authorisation in both the UK and the EU27

13 Capital market firms will need to ensure that they can continue to provide services to their clients after Brexit without interruption, especially if the UK leaves the EU Single Market. If they cannot rely on regulatory equivalence alone as the basis for providing services between the UK and the EU27, the main alternative is to be authorised (or licensed), capitalised (eg by establishing a subsidiary) and staffed in both the UK and the EU27, where they are not so authorised already.[23] The key question is what the minimum requirements in the UK and the EU27 will be, and whether they will be the same in different national jurisdictions throughout the EU27:

- Banks in the UK need to decide how to maintain access to the EU Single Market, if the UK leaves the Single Market on Brexit. The main option considered by the ECB is for banks "to set up a subsidiary in an EU country. This requires a banking licence. In the euro area, it is the ECB that grants these licences. And rest assured that we will stick to our high standards."[24]
- In the case of the securities markets, ESMA has set out general principles "to ensure a consistent supervisory approach to safeguard investor protection, the orderly functioning of financial markets and financial stability". In particular, ESMA states: "National competent authorities should reject any relocation request creating letter-box entities where, for instance, extensive use of outsourcing and delegation is foreseen with the intention of benefitting from an EU passport, while essentially performing all substantial activities or functions outside the EU27."[25]

18. The European Council guidelines state that "a non-member of the Union that does not live up to the same obligations as a member cannot have the same rights and enjoy the same benefits as a member."

19. The Prime Minister's letter to President Tusk invoking Article 50: 29 March 2017.

20. Steven Maijoor, Chair of ESMA: *Review of the European Supervisory Authorities: Opportunities to Ensure a Safe and Sound Financial System:* European Parliament, Brussels, 8 February 2017.

21. European Commission Staff Working Document: *EU Equivalence Decisions in Financial Services Policy: an Assessment,* 27 February 2017.

22. See also Andrew Bailey, Chief Executive of the UK FCA: "We need to preserve close regulatory and supervisory links with the EU. Looking ahead, strong coordination is a sensible approach to take in order to demonstrate the strength of the system: ... comparability of rules, but not exact mirroring; supervisory coordination; exchange of information; and a mechanism to deal with differences. I would add to this importance of transitional arrangements being put in place which allow for a smooth path to the new post-Brexit world.": *Why Free Trade and Open Markets in Financial Services Matter:* Reuters Newsmaker, 6 July 2017.

23. An EU branch of a non-EU bank can only be used to provide services to clients in the relevant Member State.

24. Danièle Nouy, Chair of the Supervisory Board of the ECB: *Regulation and Supervision in Europe – Can Many Cooks Make a Good Broth?* 15 May 2017.

25. ESMA: *Principles to Support Supervisory Convergence in the Context of the UK Withdrawing from the EU,* 31 May 2017.

(iii) Access to market infrastructure

14 It is also important to avoid the risk of market disruption to the euro market infrastructure as a result of Brexit. Central counterparties (CCPs) play a critically important role in providing the market infrastructure for managing risk. Market firms are required to clear certain derivatives trades through CCPs authorised for the activity concerned, and CCPs are also used to clear other products (eg repo), where use of CCPs is discretionary rather than mandatory. Most central euro-denominated clearing currently takes place in London as an international financial centre.[26]

15 The European Commission has argued[27] that, as a result of Brexit, the framework for the recognition of third country (ie non-EU) CCPs and their supervision needs to be enhanced, because of the "potential risks to the EU's financial stability".[28] Under the Commission's proposal, ESMA, in agreement with the relevant central banks, will recommend to the Commission whether or not a non-EU CCP is of "substantial systemic importance". If so, the Commission will then have the power to decide whether or not the CCP should be required to relocate activities within the EU27 as a condition for obtaining the regulatory approvals needed to operate in the EU Single Market. The implications for capital markets relate both to location and supervision:

- *Location:* Mandatory relocation would involve costs and risks for users of capital markets. For example, if CCPs with significant euro-denominated derivatives business are required to be located in the EU27, this is likely to increase costs for end-users of the derivatives market, given current economies of scale in London from pooling liquidity in several currencies, which allow multilateral netting of transactions and a reduction in the collateral needed.[29] There is also a risk that mandatory relocation will cause market disruption, particularly if relocation is not properly organised over a sufficient period of time; and that it will lead to further capital market fragmentation,[30] if there is a response by third countries.[31]
- *Supervision:* Mandatory relocation should not be needed if there is sufficiently effective cooperation between the supervisory authorities involved. The Governor of the Bank of England has noted that the Commission's proposals "include potential provisions for deference to the rules to which a CCP is subject in its home jurisdiction in line with the intent of the G20." Cross-border arrangements for the supervision of CCPs "should be based on deep cooperation between jurisdictions and authorities who defer to each other's regimes where they meet international standards and deliver similar outcomes."[32] The question is whether sufficiently robust arrangements can be established between the UK and the EU27 or not.

(iv) Access to skills

16 Besides ensuring continued access to markets, a related issue for market firms is ensuring continued access to skills, both as regards: (i) the preservation of the rights of EU27 and UK citizens living in each other's territory before Brexit; and (ii) free movement between the UK and the EU27 after Brexit. The British Government's policy of controlling EU immigration to the UK may make free movement of highly skilled people more difficult to achieve in future than at present. It remains to be seen whether free movement of highly skilled people can be accommodated within the overall framework of UK controls over EU immigration, though the British Chancellor of the Exchequer has indicated that it may.[33]

26. Mark Carney, Governor of the Bank of England: "The UK houses some of the world's largest CCPs. For example, LCH in London clears swaps in 18 currencies in 55 jurisdictions, handling over 90% of cleared interest rate swaps globally and 98% of all cleared swaps in euros. All currencies, products and counterparties benefits from the resulting economies of scale and scope.": *A Fine Balance*: Mansion House speech, 20 June 2017.

27. European Commission proposal to amend EMIR, 13 June 2017. In addition, the ECB is seeking to amend its Statute so that it has clear legal competence in the area of central clearing. See also Francois Villeroy de Galhau, Governor of the Banque de France: "Do not let sources of systemic risks for the EU grow outside the EU.": FESE Convention, 22 June 2017.

28. The alternative view is that clearing does not need to take place in the jurisdiction in which a financial asset is denominated, as central bank swap agreements can counter any systemic risks.

29. ISDA has estimated that "a requirement that euro-denominated interest rate derivatives be cleared post-Brexit in an EU-based CCP would result in an overall initial margin increase in the range of 15 to 20%.": Letter to Commissioner Dombrovskis, 8 June 2017.

30. Mark Carney, Governor of the Bank of England: "Any development which prevented EU27 firms from continuing to clear trades in the UK would split liquidity between a less liquid onshore market for EU firms and a more liquid offshore market for everyone else.": Mansion House speech, 20 June 2017.

31. Christopher Giancarlo, Acting Head of the US Commodity Futures Trading Commission, said that an EU move to tighten control over the clearing of derivatives trades "will undoubtedly inform the evolution of US regulatory policy": 10 May 2017.

32. Mansion House speech, 20 June 2017.

33. Chancellor of the Exchequer: "While we seek to manage migration, we do not seek to shut it down.": Mansion House speech, 20 June 2017.

The risk of cross-border regulatory divergence

17 The fourth market risk is that there will be growing cross-border regulatory and supervisory divergence between the UK and the EU27 after Brexit. This is not just a question whether market access between the UK and the EU27 will be restricted if and when the UK becomes a third country on Brexit, but whether regulatory paths in the UK and the EU27 will subsequently diverge. Restriction of market access will increase the costs of compliance for market firms as they will need to operate in two separate jurisdictions – ie the EU27 and the UK – rather than one.[34] But regulatory and supervisory divergence would also create the risk of regulatory arbitrage between the UK and the EU27. If regulators and supervisors were to compete through a "regulatory race to the bottom", under-regulated activities could put at risk the stability of the international financial system as a whole. In an attempt to prevent this, the European Council guidelines state that "any future framework should safeguard financial stability in the Union and respect its regulatory and supervisory regime and standards and their application." Consequently, "any free trade agreement must ensure a level playing field, not only in terms of competition and state aid, and in this regard encompass safeguards against unfair competitive advantages through, *inter alia,* tax, social, environmental and regulatory measures and practices."

18 There is an opportunity for the UK and the EU27 to avoid regulatory divergence, as they are both represented at global level in the G20. The Financial Stability Board (FSB), which implements G20 policy, "is not a treaty-based organisation, so its standards do not have direct force in any member jurisdiction. Decisions are ultimately matters for national authorities."[35] But "equivalence regimes are easier to establish when they are based on international standards. For example, while the EU and US treat prudential capital for banking differently, both regimes are equivalent, as they are implementing a Basel international standard."[36] The Chair of the FSB has confirmed: "We now have agreed common standards that are being consistently and transparently implemented. The playing field for cross-border activities is being levelled. Opportunities for regulatory arbitrage are being reduced. In short, a platform is being created for deference to each other's approaches when they achieve similar outcomes."[37]

19 The best way of avoiding cross-border regulatory divergence is through cooperation between regulators (eg by means of mutual recognition of regulatory equivalence) and supervisors (eg by means of supervisory colleges). Where regulatory divergence *does* occur, cooperation between supervisors is even more important. Brexit needs to allow for continued and effective working relationships between the UK authorities and EU bodies, with a clear understanding of the potential risks likely to arise post-Brexit. The Chair of the FSB has stated that authorities need to "share relevant information and work together to manage cross-border challenges to financial stability. The FSB and Basel Committee have developed a number of information sharing guidelines to help foster trust and cooperation between international regulators. These include supervisory colleges and crisis management groups."

20 The consequence is that "Brexit will be a litmus test of the future of international cooperation. The UK and the rest of the EU have exactly the same rules and the most highly developed frameworks of supervisory cooperation. Their capital and banking markets are already highly integrated. They have the potential to create the template for trade in financial services."[38]

The risk of a "cliff edge" on Brexit

21 Finally, it will be important to ensure a smooth changeover in the regulatory arrangements between the UK and the EU27 when Brexit takes place, so as to avoid the risk of a "cliff edge". There will be a "cliff edge" if no agreement is reached between the UK and the EU27 before Brexit, leaving the UK to trade with the EU27 after Brexit under WTO and GATS rules.[39] Alternatively, even if there *is* an agreement before Brexit, there will still be a "cliff edge" if the agreement involves a significant change in the regulatory regime when Brexit takes place, particularly if there has been insufficient time to prepare for the change.

22 Although the withdrawal agreement under Article 50 needs to take account of the framework for future relations between the UK and the EU27, it is very unlikely

34. See the ECB: "Moving from a centralised wholesale banking market based in London towards a potentially more fragmented landscape, and thereby forgoing synergies reaped from the economies of scale and scope of the City of London, could increase the cost of capital for households and non-financial corporations." The Financial Stability Review, May 2017.

35. Mark Carney, Chair of the FSB and Governor of the Bank of England: *What a Difference a Decade Makes*: IIF, Washington, 20 April 2017.

36. Sir Jon Cunliffe: Evidence to the House of Lords European Committee: *Brexit: Financial Services*, 15 December 2016.

37. Mark Carney: *What a Difference a Decade Makes:* IIF, Washington, 20 April 2017.

38. Mark Carney: *What a Difference a Decade Makes:* IIF, Washington, 20 April 2017.

39. The GATS Annex on Financial Services contains a "carve-out clause" for "measures for prudential reasons".

to be possible to negotiate and implement a detailed new trade agreement before Article 50 expires. (A new trade agreement between the UK and the EU27 is likely to be much more complex than the agreement between the EU and Canada, which took seven years and does not fully cover financial services.) The European Council guidelines state that it "stands ready to initiate work towards an agreement on trade, to be finalised and concluded once the UK is no longer a Member State."

23 So agreement will need to be reached during the negotiations *before* Brexit on a transitional period – which is referred to by the British Government as an "implementation phase" – *after* Brexit to provide a degree of regulatory continuity and certainty until a new free trade agreement between the UK and the EU27 can be reached. If agreed early during the Article 50 negotiations, a sufficiently long transitional period should help reduce execution and operational risks for market firms involved in the capital markets and help ensure a smooth transition on Brexit.[40] The British Government recognises the importance of "negotiating mutually beneficial transitional arrangements to avoid unnecessary disruption and dangerous cliff edges" and is confident of "early agreement" on this.[41] And the European Council guidelines specifically provide for a transitional period: "To the extent necessary and legally possible, the negotiations may also seek to determine transitional arrangements which are in the interest of the EU and, as appropriate, to provide for bridges towards the foreseeable framework for the future relationship in the light of the progress made. Any such transitional arrangements must be clearly defined, limited in time, and subject to effective enforcement mechanisms."

Conclusion

24 It is important to address these five risks in international capital markets during the Brexit negotiations in order to prevent capital market fragmentation and to ensure that financial stability is maintained. Addressing these risks will also help capital market firms to prepare, once the terms of a future trade agreement between the UK and the EU27 are known.[42] In some cases, market firms will need long lead-times, particularly where they need to be authorised to operate in the EU27 or in the UK, if they are not so authorised already.[43] Even if they are already authorised, operating from two centres in Europe rather than one is likely to increase capital and running costs, as well as the costs of moving staff, and may affect the competitiveness of their business. In both cases, they may need to take decisions – at least for the period immediately after Brexit – before the outcome of the negotiations between the UK and the EU27 is known.

ICMA's role

ICMA's role on Brexit is to encourage efficient and integrated capital markets, which are necessary to support economic growth. We are not lobbying for any particular financial centre. We are discussing capital market preparations for Brexit with members through our Market Practice and Regulatory Policy Committees and reporting to our Board. We are keeping in contact with the authorities in the UK, the EU27 and the euro area. We are also keeping our Brexit webpage up-to-date, not just with our own work, but also with links to work by law firms and others, so as to provide information for members.

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40. However, this may only put off market disruption until a later date if market firms are not properly prepared for a free trade agreement, when it comes into force.

41. Chancellor of the Exchequer: Mansion House speech: 20 June 2017.

42. See, for example, the ECB: "It is important that banks engage in proper and timely planning to reduce the risks of a cliff-edge effect, especially if no transitional agreement is reached. Generally, risks appear to be contained, provided that affected entities adequately plan for a "worst case" scenario.": Financial Stability Review, May 2017.

43. In the third quarter of 2016, new wholesale authorisations in the UK took 21 weeks on average.

Review of the European Supervisory Authorities

By David Hiscock

On 21 March 2017, the European Commission launched a public consultation on the operations of the European Supervisory Authorities (ESAs), which was designed to gather evidence from all interested parties, focusing on a number of issues in four broad areas: (i) tasks and powers; (ii) governance; (iii) supervisory architecture; and (iv) funding. This article summarises ICMA's input and the Commission's report on the overall inputs.

ICMA's input to the review

ICMA's response, of 15 May, focused on those selected aspects of the consultation where it was considered that ICMA had substantive points to raise.

Concerning the ESAs' existing tasks and powers, ICMA's response supported the objective of supervisory convergence, suggesting some ways in which the ESAs' existing roles might usefully be enhanced to achieve this and encouraging the adoption of some form of power for the ESAs which would operate in a manner akin to "no-action letters" used in the US. ICMA also proposed a number of ways in which existing Q&A processes could be improved, with a focus on greater transparency, more open debate and a right of appeal. ICMA underscored its belief that in the area of investor protection there are two distinct markets which require different approaches. The first of these involves professional clients engaged in wholesale markets, where there clearly needs to be a standardised, single market approach. Distinctly different from this first case, ICMA sees merits in having NCAs playing a much greater role in the application of strict controls in order to ensure retail investors' protection. And ICMA proposed an increase in the ESAs' investor education role.

Considering the international aspects of the ESAs' work, ICMA supported the ESAs having a role in the ongoing monitoring of equivalence, alongside a strong contribution to the development of international standards. At the same time, the importance of maintaining the EU's global competitiveness should require intense focus on maintaining effective EU-wide regulation in a manner which is proportionate, and which does not unnecessarily inhibit business flows into or out of the EU. ICMA also expressed the view that there should be a move towards a more unified equivalence regime in EU legislation, allowing the possibility to achieve greater consistency and thus simplify the work required in this complex area. And ICMA observed that post-Brexit it is going to be important to have robust ways for the ESAs to work closely with the relevant UK authorities.

On the question of data reporting, ICMA called for streamlining of requirements, suggesting that what really seems to be needed, in the longer term, is to establish a single EU reporting hub into which all data would flow in accordance with uniform standards. Reports required to be received by national, regional and international authorities would then be delivered from out of the data hub; and applicable market information, such as a single consolidated tape, could also potentially be generated. ICMA also suggested that a focus on what is essential, rather than nice to have, could already identify significant potential cuts, thereby alleviating unnecessary burdens on both market participants and public authorities.

Finally, in relation to governance of the ESAs, ICMA commented supportively on the role of stakeholder groups, which serve as an important source of informed views for the ESAs. ICMA considers that it is essential for stakeholder groups to be able to benefit from an appropriate level of informed industry input and also underscores the importance of having the work of ESA standing committees being supported by consultative working groups, made up of external stakeholder representatives.

Reported outcome of the review

DG FISMA received 227 responses to the consultation, which came from a wide variety of respondent groups – including EU and national authorities (government ministries, central banks, supervisors/regulators), industry associations, companies, trade unions, consumer organisations and think tanks. An additional number of comments, position papers and contributions were received outside the consultation, including official positions provided by some governments. Even though these are not reflected in the figures shown in the factual feedback statement published on 21 June, they have also been taken into account in the analysis of the legal and factual situation, and in the preparation of the steps ahead. The consultation will feed into the review of the ESFS to strengthen the effectiveness and efficiency of oversight of the financial sector, which is foreseen in the Commission's 2017 Work Programme.

Considering tasks and powers, most respondents support a greater role for ESAs in improving supervisory convergence, whilst highlighting the need to respect the principles of subsidiarity and proportionality and NCAs' room for discretion in their day-to-day supervision; and calling for greater transparency in ESAs' work. In terms of new tools, many stakeholders, primarily from industry but also including ESMA, suggest exploring the possibility for ESAs to issue documents similar to no-action letters used by other supervisors (eg in the US) to remove or temporarily suspend certain obligations. And, the vast majority of respondents identify weaknesses in the definition and application of ESAs' tasks and powers on guidelines and recommendations.

With regards to the international aspects of the ESAs' work, half of the respondents give a clear answer in relation to extending ESAs' tasks in the area of monitoring and implementing equivalence and increasing the role in coordinating NCAs' dealings with third country authorities. A clear majority, including all ESAs, support increasing ESAs' responsibilities in *ex post* monitoring and implementing equivalence decisions; and nearly a third of respondents would also welcome more general changes to the EU equivalence framework. Additionally, most respondents favour a greater coordinating role for ESAs in the field of reporting – while acknowledging the complexity of the task and welcoming ESAs' efforts to date.

With regards to a possible extension of ESMA's direct supervisory powers in the context of CMU, the vast majority of the respondents (of whom the majority are private sector stakeholders) support direct ESMA supervision of CCPs and centralising ESMA's powers (via supervisory colleges) to overcome the current fragmentation and inefficiency. Meanwhile, the majority of the limited number of stakeholders replying on direct supervision of the asset management industry see this as not desirable, with most arguing that local NCAs' are better placed to address national markets' needs. However, a significant minority – particularly elements of the industry which are active across borders – recognise potential merits in ESMA's direct supervision of EU regulated investment funds or those which conduct cross-border activities.

Only half of the participants to the consultation assess the current governance set-up of the ESAs and the views of these respondents diverge. Most respondents agree that it is difficult to ensure a proper balance in the stakeholder groups together with the geographical balance; and the majority of respondents call for more transparent selection and membership. Yet, in general, many respondents from the industry do advocate greater involvement of stakeholders.

Concerning supervisory architecture, almost half of the respondents do not reply to the questions while a few of them explain there is no optimal architecture of financial supervision and it is difficult to choose a model in abstract terms. The vast majority of the replies (which includes EBA and EIOPA) find the current sectoral supervision functions work well and satisfactorily and do not support the twin peaks model, but some consumer organisations do advocate a twin peak model of supervision by separating market conduct from prudential supervision. Some stakeholders favour fostering the role of the Joint Committee in order to ensure better coordination between the ESAs.

Lastly, on funding, around half of respondents do not reply, but the majority of those that do, including almost all industry, oppose ESAs being fully funded by the industry; and a smaller majority, including industry associations and public authorities, also oppose a system partly funded by the industry. Meanwhile, views are fairly balanced on the question of the funding allocation methodology, while most industry stakeholders argue that the respective NCA should collect any new direct contributions on behalf of the ESAs.

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ICMA's response supported the adoption of power for the ESAs which would operate in a manner akin to "no-action letters" used in the US.

The European credit repo market: the cornerstone of corporate bond market liquidity *By Andy Hill*

Background

In June 2017, ICMA published the report of its study into the state and evolution of the European credit repo market, *The European Credit Repo Market: The Cornerstone of Corporate Bond Market Liquidity*. This study builds on ICMA's previous work with respect to both corporate bond market and repo market evolution and liquidity, and investigates the European credit repo market from the perspective of its role, structure, participants, dynamics, external impacts, challenges, opportunities, and potential evolution, particularly to the extent that this plays a pivotal role in overall corporate bond market liquidity.

Overview

The repo and securities lending market for corporate bonds (the "credit repo market") is, on many levels, fundamentally different to the larger sovereign bond repo markets. The primary, though not exclusive, role of the credit repo market is to help facilitate the liquidity provision of corporate bond market makers. Corporate bond market makers are reliant on a functioning credit repo market, both to fund any long positions that they take onto their books as well as to cover their short sales in order to make good delivery. To the extent that efficient and liquid corporate bond secondary markets are essential in supporting the vital link between corporate capital raisers and investors, the health of the credit repo market plays a direct and critical role.

Market structure

Banks are very much at the centre of the credit repo market, and the main drivers and facilitators of market activity: principally to support their corporate bond market-making activity, but also as financing liquidity providers to their clients who are active in the corporate bond markets. Bank models tend to vary with respect to credit repo, with some focused purely on financing their bond trading desks, while others are, to different degrees, also focused on servicing clients, while some banks also extend their liquidity provision to competitor banks.

The state and evolution of the market

Supply

The capacity for the credit repo market to function effectively is highly dependent on the supply of corporate bonds into the market. To a limited extent, supply will derive from dealers' trading books. However, the significant majority of supply comes from investors who are the primary holders of corporate bonds. The extent to which holders are able and willing to lend their holdings back into the market, whether directly or through agent lenders, has a direct bearing on the ability and willingness of banks to support the market-making function that underpins bond market liquidity.

What the study reveals is that, for the most part, supply into the European credit repo market is relatively good, particularly with respect to investment grade corporates. And while repo rates for specials, particularly in the high yield space, can be expensive and volatile, there is still usually

44. See *Remaking the Corporate Bond Market*, ICMA, 2016, and *The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market*, ICMA, 2014.

45. See *Perspective from the Eye of the Storm: the Current State and Future Evolution of the European Repo Market,* ICMA, 2015.

availability. However, the changing nature of the underlying market, with a trend toward smaller trade sizes and more rapid turnover of dealer positions, is making sourcing supply more difficult. While there may be plenty of bonds in the lending programmes, there is little or no economic incentive to lend small sizes for short durations.

Looking forward, the single biggest challenge to supply is the CSDR mandatory buy-in regime. The overarching market view is that this will have dramatic and potentially devastating consequences for credit repo market liquidity. Quite simply, it is the ultimate deterrent to lending corporate bonds.

Intermediation

While a significant amount of dealer shorts is covered directly with agent lenders, credit repo desks and bank funding desks play a critical role in pumping both corporate bond specifics and general collateral through the system, financing not only their own trading books, but also other dealers and clients, as well as facilitating collateral management services both for their own banks and their clients. While credit repo and banking funding desks seek to transact in ways that optimize balance sheet, credit repo is still relatively capital intensive, and while the market seems to be highly efficient at pricing in the cost of capital, these costs ultimately work their way into the bid-ask spreads of market makers, and so back to bond market investors.

While any increase in the cost of capital to support credit repo intermediation has an impact on corporate bond market pricing, the biggest challenge to credit repo intermediation is likely to come from the application of the Net Stable Funding Ratio (NSFR), which will increase the cost of borrowing corporate bonds significantly. Again, the additional costs of NSFR on credit repo intermediation will need to be passed on to dealers and clients through the repo rates, and so ultimately into the pricing of the underlying market. However, there is also a risk that the cost of NSFR, with the additional long-term funding that may need to be raised to support repo market intermediation, may result in the reduction in or withdrawal of credit repo desks' services, beyond financing their own trading desks.

Electronification

While ongoing and future challenges to supply and intermediation will ultimately determine the credit repo market's ability to play its pivotal role in supporting corporate bond market liquidity, there would certainly seem to be scope for creating efficiencies through automating much of the highly manual and labour-intensive process of the market: whether in terms of sending and processing locates, trade execution, negotiating and executing re-rates, re-calls, and returns, handling corporate actions, monitoring fails, and the straight-through-processing of confirming and settling trades, as well as subsequent lifecycle events. To the extent that any solutions can also support regulatory reporting requirements, or generate useful or saleable data, the greater its potential value to stakeholders.

Automating the credit repo market is not straightforward, given the intricacies and nuances of the market, with the market becoming even more complex and fragmented with every layer of regulation. Yet there seems to be a need and an opportunity, not least given the rapid expansion of platforms and e-solutions in the corporate bond markets. However, the market seems to function relatively well for now. And ultimately, as with the underlying bond market, technology can help to produce market efficiencies, but it cannot create liquidity.

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While repo rates for specials can be expensive and volatile, there is still usually availability.

Bail-in versus bail-out: two contrasting case studies

By Katie Kelly and Tim Skeet

The ICMA Bail-in Working Group (BIWG) has for some time been evaluating the impact on investors of the Bank Recovery and Resolution Directive (BRRD). The BRRD marks a significant departure from past practice, establishing the bail-in mechanism for dealing with failing banks that no longer calls upon the public purse in the form of the taxpayer, but writes down the value of a failing bank's liabilities to match its losses – a logical move following the 2007-2008 financial crisis, when few fixed income investors suffered write-offs, even in respect of subordinated securities.

While the BIWG has welcomed the BRRD in principle, it has presented several position papers to the ECB and others calling for, *inter alia*, appropriate levels of disclosure and transparency for investors. Much of the work of the BIWG has been to examine the bail-in mechanism, and to evaluate the detail of how failing banks will be dealt with in practice, as to which a seminar was held in April 2017.

The market has had to wait before seeing how the BRRD might be applied and how consistently it would be adopted. Recent regulatory interventions in Spain in the case of Banco Popular and in Italy, where Banca Popolare de Vicenza and Veneto Banca were both closed down, present two apparently conflicting versions of how the pan-European regulatory intervention might work in practice. However, while one is a good case of a bail-in under the BRRD framework and not requiring taxpayer funds, the Italian case appears to be a classic bail-out where taxpayers' money is committed.

Despite the apparently different approaches in southern Europe, both approaches were nevertheless predictable and consistent up to a point. Investors might conclude that the divergence in approach is a function of the different stage of recovery between the Spanish and Italian banking markets, along with some specific local concerns.

The Spanish case

The action taken in early June by the ECB in the shape of the Single Resolution Board (SRB) dealing with Banco Popular in Spain offered a first glimpse of how the new bail-in regime might work in practice. There are lessons to be learnt from this recent intervention, in which Banco Popular was sold to Banco Santander for a nominal one euro, and the shareholders, the holders of deeply subordinated Contingent Convertible additional Tier 1 instruments together with the holders of the less subordinated dated Lower Tier 2 ("Tier 2") debt were collectively written down to zero.

The action to resolve Banco Popular was generally welcomed as a swift, effective and seemingly proportionate intervention designed to stabilise a risky situation and resolve the bank before matters spun out of control, broadly consistent with the SRB's previous disclosures regarding their interpretation and application of the bail-in rules.

Nevertheless, several questions inevitably arise. The BIWG has long warned of investors' inability to measure the true likelihood of a bank failing (its "probability of default") and gauge the degree of write-down faced when a bank fails (the "loss-given default"). In this case, the degree of Banco Popular's difficulties was surprising, having passed the regulatory stress tests in 2016 and published acceptably strong capital and liquidity ratios – key indicators of a bank's creditworthiness.

Investors might have concluded that the bank's difficulties were manageable, so the sudden intervention of the SRB was as reassuring in its speed and effectiveness as its impact proved disconcerting on certain debt investors. As there has been no valuation of the bank's position made public at the time of writing, investors can only speculate on the specific loss-given default calculations and the timing and urgency of the intervention. There may always, however, be an expectation that regulators will err on the side of being conservative in terms of speed of intervention and quantum of write-down to resolve a bank, exposing investors to severe losses.

In the case of Banco Popular, no senior unsecured creditors were affected – cold comfort perhaps to holders of Tier 2 debt who may have felt that losses should have been more widely spread. As a result, investors may want to apply more stringent valuation criteria when pricing risk of bank securities, and also evaluate the risk that lower yielding and higher-ranking tiers of debt may end up as risky as the more obviously subordinated securities.

Once confidence fails, the value of assets and the ability of a bank to fund itself is depleted very quickly indeed, so banks may now jump straight to resolution, calling into question the relevance of capital ratios, trigger levels and conversion features. Notwithstanding, the key question for investors remains: where do regulators set the Point of Non-Viability (PoNV)? As Banco Popular demonstrated, it was clearly not where the market had anticipated.

Banco Popular was, moreover, a Spanish solution to a Spanish problem, whereby a large, well-capitalised and larger rival could step in quickly. In future, an absence of an obvious industry saviour could render a restructuring far more problematic.

The Italian case

By contrast, the actions over the two regional lenders in Italy, Vicenza and Veneto, which required €17 billion of Italian Government money in various forms, represent a different model to BRRD. In this case the two banks were liquidated, the shareholders and any junior note holders wiped out and the assets sold to Intesa Sanpaolo at a discount, with state guarantees to cover potential further losses. No senior debt holders were written down as in the Banco Popular case, but here the quantum of losses far outstripped the capital available.

This situation should have not surprised anyone. Whereas Banco Popular had appeared weakened but able to continue, the two Italian banks along with some others have been on the critical list for some time. As the BIWG has consistently pointed out, the problems here are part of the pre-crisis legacy and should not be subject to a bail-in regime introduced subsequently. To this extent the Italian authorities appear to have recognised the difficulty. The additional complication in Italy is the fact that many debt holders are retail buyers and previous attempts to bail-in this category of investor has proved politically and socially unacceptable.

As a further consideration, the Italian regional lenders were crucially deemed non-systemically important, allowing the banks to bypass resolution and go straight to liquidation. DG Competition waved this through and the BRRD was not invoked. Observers might conclude that this long-expected action represents a cleaning up of legacy problems in Italy where bail-in would not have been sufficient to deal with the problem.

Conclusion

The central lesson for investors will be essentially that the degree of loss on bank securities could be unexpectedly severe (with no right of appeal), and they may have little oversight of where PoNV lies. The inconsistency between the Spanish and Italian actions further serves to emphasise the subjective and essentially local nature of some decisions which nevertheless have a great impact on the value of a bank's debt securities, and which will present yet another challenge for investors who now have to calibrate the political balance between national and European authorities. These differences should not, however, invalidate the expectations for the future use and consistency of the application of the BRRD, where predictability, transparency and understanding of the moving parts are key to instilling confidence.

A conundrum at the heart of the BRRD is that regulators are privy to certain information to which investors are not – a situation which is necessary in order not to undermine their ability to intervene in an orderly and timely manner. How this plays out and what impact this will have on market access and pricing for banks of all sizes and profiles will be closely watched.

The BIWG will be following these cases closely while making recommendations to the regulatory authorities to lessen the surprise and severity of bank failures while ensuring stable and functioning markets in the future. Investors will draw lessons over the degree of risk they bear as debt holders versus equity holders, and should continue to call for a review of banking governance and of the risk-reward ratio implicit in the different types of securities issued by banks.

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The panda bond market and perspectives of foreign issuers

By Mushtaq Kapasi

China's bond market has grown to RMB63 trillion (more than US$9 trillion) as of the end of 2016, making it the third largest in the world. On the other hand, efforts to make the domestic bond market more accessible to foreign issuers and investors are still in the early stages. With ongoing reform of the Chinese securities markets and the RMB exchange rate regime, China's bond market will continue to attract stronger interest from foreign institutions – not only from investors, but also from issuers in the panda bond market.

A "panda bond" is a debt security issued in the domestic Chinese market by a foreign institution registered outside the People's Republic of China, including institutions registered in Hong Kong, Macau and Taiwan. Panda bonds are usually denominated in RMB but may be issued in other currencies such as Special Drawing Rights of the International Monetary Fund.

Panda bonds are distinguished from "dim sum" bonds, which are denominated in RMB but issued in the offshore markets. Panda bonds are also not the same as Chinese domestic bonds, which are issued by onshore Chinese entities and subject to different sets of regulations specific to onshore issuers.

Panda bonds, as now generally understood, include bonds issued in both the Chinese domestic interbank bond market (which accounts for most Chinese bond issuance and trading) and the Chinese domestic exchange-traded bond market. Also, panda bonds may technically include bonds issued by offshore affiliates of Chinese entities, such as Hong Kong subsidiaries of Chinese corporates.

The People's Bank of China and NAFMII have promoted the development and expansion of the panda bond market by conducting intensive research on cross-border regulation practices in the overseas bond market, facilitating registration of pilot cases and enhancing institution building. As of the end of March 2017, 35 panda bond issuers have entered the Chinese interbank market. Types of issuers include international development institutions, sovereign governments, financial institutions, and non-financial enterprises. As of the end of March 2017, foreign issuers have issued a total of RMB79 billion (US$11 billion) panda bonds through 40 transactions; the current outstanding volume is RMB69 billion (US$10 billion).

ICMA and NAFMII, pursuant to the 2016 UK-China Economic and Financial Dialogue, have jointly conducted an extensive study of the motivations and concerns of foreign issuers with respect to the panda bond market.

Overall, the panda bond market is potentially attractive to foreign issuers for a variety of reasons:

- *Funding onshore operations:* Many foreign corporates have significant economic ties to China, as a consumer market, operational hub, and/or manufacturing centre. Raising RMB directly onshore can simplify cash flow operations and reduce potential currency risk to match their RMB funding needs.
- *Investor diversification:* The corporate finance policy of many issuers includes investor diversification as a core funding principle, and the large Chinese bond market investor base presents a significant opportunity to expand the base of creditors.
- *Liquidity:* The onshore bond market, as a whole, is perceived to be generally more liquid than the offshore dim sum market. This is a potential advantage for issuers who seek RMB but are considering whether to issue RMB bonds offshore or onshore.
- *Marketing considerations:* The greater overall accessibility of China has led to stronger economic and financial ties between domestic and foreign markets. Issuance of panda bonds by foreign institutions helps domestic market participants to develop a better understanding of how these institutions operate, builds trust between the two sides, and ultimately fosters the sustainable and efficient operation of foreign institutions in China. Furthermore, panda bond issuance by foreign government organizations also contributes to deepen bilateral financial cooperation and trade relations.
- *Global funding:* The Chinese onshore bond market, like other international markets, may present an opportunity for foreign issuers to obtain funding in their primary currency (usually US dollars, euro

or pounds sterling) at attractive rates by issuing in RMB and entering into a cross-currency swap for their primary currency.

- *Market innovation:* The issue of some panda bonds to date has been motivated at least in part by a desire to be one of the first to market with an innovative transaction.

Most of the issuers surveyed by ICMA expressed serious interest in the panda bond market and a willingness to manage any additional costs and risks relative to other markets. At the same time, they welcomed further guidance and clarity on the issuance procedure to have more certainty over the issuance timetable and their ability to satisfy the regulator's requirements for a successful issuance. A more regulated and institutionalized panda bond market would help stabilize the expectations of market players and increase market efficiency. Currently, the regulatory rules governing domestic bonds serve as the basis for the regulatory framework for panda bonds, which is being adjusted in view of the special requirements of foreign issuers on the use of proceeds, preparation of registration documents and information disclosure.

The issuance of panda bonds in China by foreign institutions is similar in many respects with the issuance of regular bonds in the Chinese interbank market. The main difference is the cross-border financing aspect. As a result, China has adopted a proactive yet gradual and prudent pace in the initial stage of the panda bond programme, granting access to selected high-quality issuers. Chinese policy makers expect to conduct further studies and analysis before promulgating formal regulations governing the panda bond market.

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Legal & Regulatory Helpdesk service for ICMA members

Since the Legal & Regulatory Helpdesk was established, ICMA has provided this free of charge service to its members and responded to over 1,000 member enquiries. This resource allows members to contact ICMA at any time and to discuss regulatory and market practice issues. We strive to respond very promptly with clear and helpful practical answers and guidance. Sometimes if the subject is outside our experience we still may assist members with narrowing the issues which our members find very useful if they need to seek outside professional advice. All members are encouraged to make the most of this offering. We welcome members to "come early and come often" with their questions.

For legal enquiries: legalhelpdesk@icmagroup.org
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Frequently asked questions are published on
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ICMA's Legal and Regulatory Helpdesk offers members guidance in the following areas:

ICMA Legal
- ICMA Primary Market Handbook
- ICMA Rules and Recommendations for the Secondary Market
- Global Master Repurchase Agreement (GMRA)
- ICMA GMRA Legal Opinions
- ICMA Conciliation and Arbitration

ICMA Market Practice and Regulatory Policy
- Securities market regulation
- Short term markets (ECP, repo)
- Primary markets
- Secondary markets (OTC)
- Asset management

The Secretariat and the Association's committees provide informal guidance, rather than formal advice to members on capital market as well as GMRA related issues. The underlying policy for this is to (i) ensure the fair and equal treatment of members; (ii) facilitate the integrity of ICMA's conciliation and arbitration proceedings; and (iii) limit a potential exposure of the Association for incorrect advice to the greatest extent possible. ICMA maintains records of enquiries received and guidance provided, often with the prior input from ICMA's expert committees, enabling ICMA to issue consistent guidance which is based on appropriate precedents.

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Summary of practical initiatives by ICMA

The practical initiatives on which ICMA has been engaged over the past quarter with, and on behalf of, members, include the following:

Primary markets

1. *PSIF:* The Public Sector Issuer Forum (PSIF) met at the UK DMO in London on 19 June. The agenda included a presentation by the UK DMO on its work as an issuer; a presentation on the impact of MiFID II/R on trading of SSA debt securities; and a discussion on central clearing.
2. *FMSB new issue processes:* The final version of the FICC Markets Standards Board (FMSB) new issue guidelines, published on 2 May, takes account of a number of ICMA's comments on a previous draft, and is broadly consistent with the ICMA Primary Market Handbook.
3. *Prospectus Regulation:* The Level 1 text of the Prospectus Regulation was published in the *Official Journal* on 30 June. ESMA published three consultation papers on Level 2 measures on 6 July. ICMA is planning to respond.
4. *MiFID II in primary markets:* ICMA continues to work with members in the ICMA Primary Market Practices Committee and the Legal & Documentation Committee on the implications of the forthcoming MiFID II regime for product governance, justification for allocations and inducements.
5. *PRIIPs Regulation:* ICMA is continuing to discuss, with both primary and secondary market participants, the implications of the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, taking account of the implementation date of 1 January 2018, and has circulated standard language for selling restrictions and legends for prospectuses to the ICMA primary market constituency. There may be further guidance during the summer.
6. *Bank of Italy Article 129 rules:* ICMA has helped members to implement the Bank of Italy Article 129 rules on post-issuance reporting, and has engaged with the Bank of Italy on the market's most significant concerns. Following ICMA engagement, the Bank of Italy updated its reporting platform to address some of ICMA members' key concerns.
7. *FCA/HMRC:* ICMA responded, ahead of the 14 May deadline, to the FCA consultation paper on the effectiveness of primary markets; and, ahead of the 12 June deadline, to the HMRC consultation on withholding tax exemption for debt traded on a Multilateral Trading Facility.

Secondary markets

8. *European Commission Expert Group on Corporate Bonds:* ICMA is represented by Andy Hill on the European Commission High Level Expert Group on Corporate Bond Market Liquidity. The Expert Group has been asked by the Commission to put forward recommendations by September.
9. *MiFID II post-trade deferrals:* ICMA has published a position paper on the proposed MIFID II regime on post-trade deferrals, prepared in consultation with its MiFID II Working Group.
10. *MiFID II Systematic Internaliser regime:* On 27 March and 4 July, ICMA held workshops with sell-side and buy-side market participants on the implementation of MiFID II/R in the secondary markets.
11. *CSDR settlement discipline:* On 15 May, ICMA published a position paper on CSDR settlement discipline, having consulted its Secondary Market Practices Committee. The position paper proposes that the cash penalties for bonds should be increased when CSDR is implemented in 2019, while arguing that mandatory buy-ins should not be implemented.
12. *ETP Mapping Directory:* The ICMA Electronic Trading Platform (ETP) Mapping Directory, which has recently been updated, provides a single source of information on over 30 infrastructure providers.
13. *ICMA Buy-in Rules:* Taking into account responses from a member questionnaire, ICMA has revised its Buy-in Rules in consultation with the ICMA Secondary Market Practices Committee.

Repo and collateral markets

14. *ICMA credit repo study:* ICMA published in June a new research study on *The European Credit Repo Market: The Cornerstone of Corporate Bond Market Liquidity.* The study was prepared by Andy Hill as a joint initiative of the ICMA European Repo and Collateral Council (ERCC) and ICMA Secondary Market Practices Committee.
15. *MiFID II/R and the repo market:* The ICMA ERCC has written to the European Commission (DG FISMA) in an attempt to resolve concerns about transaction reporting of securities financing transactions (SFTs) with ESCB counterparties under MiFIR and the application of MiFID best execution reporting requirements in the case of repos.

16 *SFTR:* ICMA is continuing to help members to implement the SFT Regulation, and is undertaking a bilateral reconciliation exercise to identify the most critical reporting elements requiring further industry work.

17 *Repo market survey:* ICMA's 33rd semi-annual survey of the European repo market will be based on figures for 7 June.

18 *The ERCC AGM:* The 2017 AGM of the ICMA ERCC was held in Zurich on 20 March, and provided a good opportunity to review the different challenges currently faced by the repo market, from buy-side concerns to SFT reporting.

19 *Advisory Groups:* The ERCC has continued to contribute to the European Commission's European Post-Trade Forum (EPTF) and is also represented, through ERCC Ops Co-Chair Nicholas Hamilton, in the ECB's new Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo).

Asset management

20 *AMIC Council:* The ICMA Asset Management and Investors Council (AMIC) met at Allianz GI in Frankfurt on 23 March, at which the ECB was one of the keynote speakers.

21 *Bail-in:* The ICMA Bail-In Working Group held a workshop on 7 April at the EBRD in London, chaired by Tim Skeet, to discuss with the ECB the need for transparent, consistent and comparable treatment of bad loans and encumbered assets, and a consistent approach to subordination. ICMA is following up the outcome of the workshop with the ECB and the European Commission.

22 *Covered bonds:* The ICMA Covered Bond Investor Council (CBIC) held its annual conference in Frankfurt on 1 June, including a keynote speech by the ECB on the Third Covered Bond Purchase Programme and panel discussions on covered bond harmonisation, transparency, structural changes in covered bonds and green covered bonds.

23 *AMIC Executive Committee:* The AMIC Executive Committee, chaired by Bob Parker, met on 7 June to discuss: key issues for bond holders relating to corporate governance; the Central Bank of Ireland consultation on ETFs; the effect on investors of ECB quantitative easing; and MiFID II research unbundling, among other issues.

24 *Leverage and asset management:* The AMIC Fund Liquidity Working Group is preparing a report, jointly with EFAMA, on fund leverage, as a contribution to the continuing debate (eg between the FSB and IOSCO) on systemic risk and asset management.

25 *Securitisation:* The AMIC Securitisation Working Group is analysing the outcome of the trilogue agreement on 30 May on the simple, transparent and standardised (STS) Securitisation Regulation, and is pressing the Commission to launch much needed Solvency II amendments to capital requirements for STS securitisation.

Capital market products

26 *European Commission Expert Group on Sustainable Finance:* ICMA is represented by Nicholas Pfaff as an observer on the European Commission High Level Expert Group on Sustainable Finance.

27 *Green Bond Principles (GBP):* The GBP have been updated, and new Social Bond Principles and Sustainability Bond Guidelines have been released. Elections have been held for the GBP Executive Committee. The GBP AGM took place under the patronage of the Trésor in Paris on 14 June.

28 *Global Green Finance Council:* A new Global Green Finance Council, coordinated by ICMA and involving a number of other trade associations, is meeting regularly.

29 *European Corporate Private Placement (ECPP):* The ECPP Joint Committee has held a meeting with the consultants appointed by the European Commission to advise on the removal of cross-border barriers to ECPP.

Other issues

30 *G20 regulatory reforms:* On 11 May, ICMA responded to the FSB consultation paper on G20 regulatory reforms.

31 *ESAs:* On 15 May, ICMA responded to the European Commission consultation paper on reviewing the European Supervisory Authorities (ESAs).

32 *Brexit:* ICMA has continued to keep in contact on Brexit with the UK, the euro area and the EU authorities, and to discuss with members – both in the UK and the EU27 – through ICMA Market Practice and Regulatory Policy Committees how it can best help them to prepare.

Other meetings with central banks and regulators

33 *ESMA:* Verena Ross, Executive Director of ESMA, exchanged views with members at the ICMA Regulatory Policy Committee meeting in Paris on 16 June.

34 *Official groups in Europe:* ICMA continues to be represented, through Martin Scheck, on the ECB Bond Market Contact Group; through René Karsenti, on the ESMA Securities and Markets Stakeholder Group; and through Godfried De Vidts on the ECB Macroprudential Policies and Financial Stability Contact Group and the European Post-Trade Forum, and on the Consultative Working Group to ESMA's Secondary Markets Standing Committee.

35 *Official groups in Asia:* ICMA is an official member of China's Green Finance Committee under the auspices of the People's Bank of China, and the Green Finance Study Group under the G20.

ICMA Regulatory Grid

36 The ICMA Regulatory Grid, which covers 26 new financial regulations affecting the cross-border securities markets in Europe, has been updated and is available to members on the ICMA website.

Primary Markets



by Ruari Ewing, Catherine Wade and Kate Craven

MiFID II/R product governance and PRIIPs

Introduction

ICMA continues to focus on implementation of the MiFID II/R product governance (PG) and PRIIPs regimes ahead of their coming into effect in January 2018 and following ESMA's publication of its Final Report: *Guidelines on MiFID II Product Governance Requirements*. In July were published a PRIIPs Communication by the European Commission and PRIIPs Q&A (on KID content) by the ESAs. There may be further guidance during the summer..

Legal basis

The PG regime's basis is so far in (i) MiFID II Arts. 16.3/24.2 (and related Recital 71) at Level 1, (ii) MiFID II Delegated Directive 2017/593 Arts. 9/10 (and related Recitals 15-20) at Level 2 and (iii) the above ESMA final Guidelines at Level 3.

Concept

ICMA is working on the assumption that underwriters of new bond issues may be product "manufacturers" (as broadly "advising corporate issuers on the launch of new financial instruments")[46] in addition to being initial "distributors" (involved in offering/recommending/selling). As manufacturers, they must from 2018 have processes to (i) define (and communicate to subsequent "distributors") "positive"/ compatible "target markets" (TMs – involving specified criteria) as well any "negative"/incompatible investor groups and (ii) periodically review these TMs in light of any feedback from distributors (bearing in mind the ESMA final Guidelines envisage distributors only refining rather than widening manufacturer TMs[47]). Underwriters must also have TM definition/review processes as "distributors" (though they can rely on their manufacturer TM work in this respect). The "proportionate" application of these requirements is heavily emphasised.

Need for harmonised market practice

The main ICMA focus is on the, overwhelmingly wholesale, international bond markets that borrowing businesses currently depend on to swiftly and efficiently fund much of their real economy investments (often on an intra-day basis that minimises market risk) – a key plank of Europe's CMU initiative. ICMA's aim is to develop one or more "harmonised" market-wide PG practices, that will enable such borrowers to access the markets directly without needing to await lengthy preliminary PG consensus deliberations among the multi-bank underwriter syndicate groups that borrowers put together for each transaction. Transaction parties can of course choose to apply alternative "bespoke" PG practices involving such deliberations, but will need to allow for significantly longer transaction timelines in order to develop them.

Professional investors TM

The simplest harmonised practice that seems deliverable by 2018 is an "all bonds/all professionals" proportionate TM practice. On the basis that professional investors possess the experience, knowledge and expertise to define their needs and objectives, make their own investment decisions and properly assess and manage the risks/returns that they incur (as acknowledged in Annex II of MiFID II), they should be able to buy and hold any investment, regardless of product type or the nature of the issuer/borrower, and therefore the "manufacturer" of a bond instrument should have complied with the product governance regime if it ensures that measures are put in place on issue that are reasonably expected to result in sales only being made to such

46 This odd-looking extension follows from the fact that, unlike the PRIIPs regime, the PG regime does not bind most issuers/borrowers who, being non-financial, are not MiFID entities.

47 Though this remains subject to occasional "suitability" assessments specific to individual investors outside the TM.

investors in the EEA. Such measure will likely include primary market selling restrictions (probably similar to the forms of restrictions that have begun emerging in bond programme prospectus updates in relation to PRIIPs) and legends warning of the investor base limitations – and represent a consistent approach across the MiFID II, PRIIPs and prospectus regimes. Advantages of this TM approach include:

- that its rationale is likely to endure over time and so is particularly conducive to adoption as a harmonised market-wide approach (as well as providing certainty in terms of periodic TM reviews); and
- from a PRIIPs perspective, it should efficiently avoid borrowers (as PRIIPs manufacturers) having to publish a key information document (KID – the potential civil liability for which is not expected to be acceptable to borrowers).

Retail investors TM

The scope for a 2018 delivery of a harmonised market-wide PG practice(s) involving retail investors (other than via discretionary managers who are professionals) seems more challenging, with several options being considered. In the case of delivery of no, or limited, harmonised practice(s), borrowers might need to fall back to bespoke practices to access retail investors – which they may well be unlikely to do given the transaction timeline implications. This compounds the continuing concerns over open-ended ambiguity of PRIIPs' "packaged" product scope (highlighted in prior PRIIPs coverage in this Quarterly Report). In any case, it seems direct retail investor participation in the international bond markets will be further curtailed. This seems to be acknowledged by the Summary of CMU Mid-Term Review consultation responses that states: "[...] some respondents stated that the costs and burdens for providing investment services have dramatically increased as a result of new regulations and that they may constitute a barrier to selling products to retail investors. This is primarily affecting the sale of simple products, as [...] bonds are more and more submitted to stricter rules. PRIIPs and MiFID II product governance regimes will reduce the availability of [...] simple bonds to retail investors."

The simplest harmonised practice that seems deliverable by 2018 is an "all bonds/all professionals" proportionate TM practice.

Regulated Market (RM) admission not per se retail

It is worth noting in the context of the above that purely wholesale bonds are admitted to Regulated Markets. In this respect, RM admission should not equate *per se* to targeting of, or (for PRIIPs purposes) making available to, retail investors. To decree otherwise would be inconsistent with:

- *public policy/CMU objectives:* RMs have historically operated (and this continues in the goals of CMU) on the basis that they should include a wide and deep spectrum of investment choice; such variety is enabled, and users and suppliers of capital are encouraged to participate, because RMs bring the highest levels of initial (Prospectus Directive), ongoing periodic (Transparency Directive) and *ad hoc* (Market Abuse Regulation) disclosure, and so consequent investor protection; attaching PG/PRIIPs retail consequences would involve a significant risk that RMs (and their related protections) reduce in terms of size/range;
- *investor protection objectives:* notably, ESMA has stated that only professional investors have the skill and resource set to analyse contingent convertibles instruments (CoCos), whilst producing KIDs would seem to facilitate their sale to retail investors;
- *other legislation:* the Prospectus Directive expressly contemplates a wholesale alleviated disclosure regime for RM admissions.

Other aspects of product governance

In terms of other aspects, ICMA is considering:

- the application of the PG regime outside Europe (with particular focus on the proportionality of following the requirements of local law);
- whether any negative TM would be applicable for bonds, *inter alia* given, in the absence of regulators exercising their product intervention powers, portfolio/diversification considerations;
- the status of legacy bonds ("manufactured"/issued prior to 2018) for which there is no grandfathering in respect of ongoing distributor TM or manufacturer reviews (query whether defaulting to the above "all bonds/all professionals" TM practice absent specific indication otherwise may be the least disruptive option);
- distribution of responsibilities between co-manufacturers (lead-managers, co-managers and MiFID entity issuers).

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M

Other aspects of MiFID II/R implementation in primary markets

Introduction

ICMA continues to focus on other primary market implementation aspects of MiFID II in addition to product governance (see previous article), notably in terms of allocation justification recording, inducements, costs and charges and trade and transaction reporting.

Allocation justification recording (underwriting and placing)

- *Legal basis:* The allocation justification rules arise under MiFID II's general conflict of interest provisions (MiFID II Art. 23 at Level 1), as complemented specifically regarding underwriting and placing (Delegated Regulation 2017/565 Arts. 38-43 and related Recitals 57-59 at Level 2): Delegated Regulation 2017/565 Art. 43 (and related Recital 59) at Level 2 and ESMA's investor protection Q&A (section 6, Q3 of 16 December 2016) at Level 3.
- *Concept:* MiFID firms providing a MiFID placing service to issuers will need to keep a (non-public) written record of a justification for each investor allocation made (which are relevant in the context of over-subscription). However, this does not seemingly need to be literally split out as a separate written rationale for each allocation – for example a collective justification could apply to several allocations. Nonetheless the requirement seems logistically onerous, as well as potentially challenging in terms of compatibility with current swift transaction timelines.
- *Approach:* A potential approach would be for a recorded justification "cascade" of firm allocation policies, initial issuer preferences, general decisions on average allocations and then individual justifications for deviations beyond the average allocation bands.

Inducements/costs and charges

- *Inducements regime legal basis/concept:* The inducements rules arise under MiFID II's provisions on conflict of interest and general principles and information to clients (MiFID II Arts. 23.1/24.9 at Level 1 and Delegated Directive 2017/593 Art. 11 at Level 2). Firms providing MiFID services (eg order reception/transmission to an investor "client") must disclose in advance to their client any fee/commission or non-monetary benefit received, in relation to the client service, from a third party.
- *Costs and charges regime legal basis/concept:* The costs and charges rules arise under MiFID II's provisions on general principles and information to clients (under MiFID II Art. 24.4 and Delegated Regulation 2017/565 Art. 50). Firms must *inter alia* disclose *ex ante* and annually *ex post* the costs and charges relating to the services and financial instruments concerned, also *"encompassing any third party payments"*.
- *Approach:* ICMA is considering what implications for primary markets there may be, including potential overlap between the two regimes.

Trade and transaction reporting

ESMA has specifically stated (September 2015 Final Report paragraph 278) that primary issuance is outside the scope of the (public) "trade" transparency regime (arising under MiFIR Art. 21 at Level 1). ESMA has not similarly stated in relation to (private) "transaction" reporting to regulators (arising under MiFIR Art. 26 at Level 1). Though both concepts are subject to a broadly similar "traded on a trading venue" (TOTV) scope, there is an additional confusing but subsidiary Level 2 reference (RTS22 Delegated Regulation 2017/590 Art. 2.5) to primary market scope. However, any technical difference in approach between underwriters on transaction reporting does not seem to be perceived as challenging in term of syndicate efficacy.

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MAR market soundings

Given the ongoing uncertainty around the scope of MAR's market sounding regime (see further coverage in the First Quarter 2017 edition of this Quarterly Report), ICMA has submitted the following suggested Q&A to ESMA:

ICMA question: "Is compliance with the provisions of Article 11 MAR (and the processes set out in Implementing Regulation EU/2016/959 and Delegated Regulation EU/2016/960 (the "Level 2 Sounding Regulations") obligatory?"

ICMA suggested answer: "When conducting a market sounding, disclosing market participants (DMP) must always comply with the requirements in Article 11.3, Article 11.6 and Article 11.8. Market sounding recipients (MSR) must similarly always comply with the requirements in Article 11.7. It is not mandatory for a DMP to follow the steps at Article 11.5 (see Recital 35 MAR in this regard) and amplified in the Level 2 Sounding Regulations. However:

- if a DMP follows the steps at Article 11.5 and amplified in the Level 2 Sounding Regulations (as well as complying with Article 11.3), it will be able to take advantage of the protection set out at Article 11.4 of MAR, such that the disclosure of inside information in the course of a market sounding will be deemed to be made in the normal exercise of a person's employment, profession or duties;
- if a DMP discloses inside information but does not follow the steps at Article 11.5 and in the Level 2 Sounding

Regulations, the DMP will need to demonstrate that the disclosure was made in the normal exercise of their employment, profession or duties, in order to comply with Article 10 MAR.

It is not a breach of MAR for a DMP not to follow the processes and requirements set out in the Level 2 Sounding Regulations (including Article 3(1) and 3(4) of Delegated Regulation 2016/960) when disclosing information which is not inside information during a market sounding."

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EU prospectus regime

The Prospectus Regulation was published in the *Official Journal* on 30 June 2017. The final text includes several technical amendments since the final compromise text of the Prospectus Regulation dated 16 December 2016. The Regulation will enter into force on 20 July 2017. Most provisions will apply two years from the date of entry into force (ie 21 July 2019), although some provisions will apply earlier.

ESMA commenced its consultation on Level 2 measures on 6 July, publishing three consultation papers. The three consultation papers follow from the European Commission request to ESMA for technical advice on possible delegated acts published in February 2017 and contain draft technical advice on the format and content of the prospectus, on the EU growth prospectus and on scrutiny and approval. The consultation period runs until 28 September 2017 and ICMA intends to fully engage in the consultation process over the summer period, involving its Prospectus Regulation Working Group.

It is interesting to note from the European Commission request for technical advice, that the Commission appears to have chosen not to exercise its power to adopt delegated acts to supplement the Level 1 requirements relating to risk factors. The new Level 1 provisions on risk factors are expected to be a key concern for issuers of debt securities, as they introduce new requirements to assess the materiality of risk factors based on the probability of their occurrence and the expected magnitude of their negative impact, to present risk factors in a limited number of categories depending on their nature and to mention the most material factor in each category according to the issuer's assessment of materiality. It is not clear how these new, high level requirements will impact in practice, particularly without more detailed guidance or other measures at Level 2 or 3. It is hoped that ESMA may consider this in approaching its work on the Prospectus Regulation.

Ahead of the ESMA Level 2 consultation, ICMA emphasised two key themes in communications and discussions with the Commission, ESMA and various other relevant regulators and official institutions. These are areas which could have considerable significance for debt market participants:

- *Article 13: Minimum information and format of the prospectus:* This relates to the detailed disclosure requirements for prospectuses. ICMA's proposal is to leave the current disclosure annexes broadly unchanged and to reflect the statement in Article 6 that the "necessary information" for an investment decision depends on, among other things, the type of security, by setting out different overriding disclosure tests for different types of securities and state that disclosure of specific items in the annexes is only needed to the extent that it is pertinent to the relevant disclosure test. ICMA welcomes ESMA's CP proposal to leave the wholesale debt disclosure annex largely unchanged.
- *Article 22: Advertisements:* The change in the definition of what constitutes an advertisement, from the existing prospectus regime to the final Level 1 text of the Prospectus Regulation, to mean a "communication" rather than "announcement" means that it risks capturing bilateral communications (written or oral). The impact of this change would be disproportionate and could undermine

The Commission appears to have chosen not to exercise its power to adopt delegated acts to supplement the Level 1 requirements relating to risk factors.

> **The costs to underwriters in complying with these rules have been significant.**

the effectiveness of the market soundings regime under the Market Abuse Regulation which provides a regulatory framework for private bilateral communications. The ICMA proposal is that advertisements be interpreted as only communications that are of general import or widely disseminated. ICMA staff had the opportunity to discuss this (among other matters) at the European Commission Prospectus Regulation Workshop on 29 March and we note from the (informal and non-binding) "key takeways from the working sessions" paper circulated after the workshop that this was a view on which there was a broad consensus. It is hoped that ESMA will consider further guidance to address this concern, at Level 2 or Level 3 as appropriate.

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Bank of Italy Article 129 reporting requirements

As reported in the last edition of Quarterly Report, the introduction of the Bank of Italy's Article 129 reporting requirements for underwriters placing securities in Italy was not as smooth as one might have hoped. To recap, underwriters experienced several unexpected practical difficulties in operating the platform and there were ambiguities in some of the information reporting requirements. The costs to underwriters in complying with these rules have been significant, with some banks considering the need to hire dedicated staff to handle the new reporting burden.

A specific challenge encountered by underwriters of syndicated issues of bonds, which are typically allocated using the pot system, was that the reporting system only allowed for reporting by one underwriter, envisaging that the billing and delivery (B&D) bank would report all information. In the case of pot deals where there may be "exceptions" placed by one or more underwriter(s) outside of the pot system, this required the B&D bank to gather that information from the other syndicate members and report the exceptions on their behalf which could result in time delays in reporting, inefficiencies and potentially inaccurate reporting.

Following ICMA's engagement with the Bank of Italy in the latter part of last year and the early part of this year, the Bank of Italy announced amendments to its reporting platform and updated its instruction manual and FAQs as of 11 April 2017. These changes (which came into effect immediately) have been welcomed by market participants as they allow more flexibility in the reporting of securities placed in Italy, particularly in relation to pot deals. The updates allow for more than one underwriter to input information in relation to a specific bond issuance. This is particularly helpful in relation to the reporting of exceptions placed outside of the pot system. The Bank of Italy's engagement with ICMA and its members to make improvements to its reporting system to address practical issues faced by members is very welcome. We continue to receive feedback from members with technical queries or practical issues relating to the platform and will provide updates and continue to liaise with the Bank of Italy as appropriate.

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Withholding tax exemption for debt traded on a Multilateral Trading Facility

As mentioned in the last Quarterly Report, HM Revenue and Customs (HMRC) announced a consultation proposing the introduction of a new exemption from withholding tax for interest on debt traded on a UK Multilateral Trading Facility (MTF).

ICMA responded to this consultation welcoming the proposal and noting that the introduction of a new exemption to cover debt traded on wholesale UK MTFs could contribute to the competitiveness of UK wholesale primary debt markets and, by increasing listing options and therefore flexibility for debt issuers, could help to make debt markets more efficient.

Introducing this new exemption would be advantageous for the London Stock Exchange Group's new MTF for debt securities (the International Securities Market) as it would make listing on a UK MTF a viable option for UK issuers (who currently benefit from the Quoted Eurobond Exemption (QEE) when listing debt securities on existing non-UK MTFs).

ICMA also noted that the current QEE does not extend to securities issued by local authorities. Using the proposed new withholding tax exemption to clarify that a security issued by a company or local authority could benefit from a withholding tax exemption would be helpful and remove a barrier preventing local authorities from listing in the UK.

In its response, ICMA expressed a marginal preference for the proposal to be achieved by widening the existing QEE, and a hope that the required legislative changes take effect as soon as possible. ICMA had previously responded to the FCA's Discussion Paper DP17/2, *Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape*.

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Other primary market developments

- *FMSB new issue standard:* On 2 May, the FICC Markets Standards Board published its final *New Issue Process Standard for the Fixed Income Markets*. This followed ICMA's comments (also covering some aspects of FMSB's general processes) submitted in relation to the preceding transparency draft (see further coverage in the First Quarter 2017 edition of this Quarterly Report under "Other primary market developments"). The changes in the final standard appear to address some of ICMA's comments without introducing significant new aspects.

- *FCA ICB Market Study/contractual ties***:** The UK's FCA has published Policy Statement PS17/13 *inter alia* setting out a ban on agreements from 3 January 2018 that give a right to provide future primary market services (excluding bridging loans). Further to the FCA ICB Market Study (see previous coverage in the First Quarter 2017 edition of this Quarterly Report under "Other primary market developments"), the FCA has initiated other workstreams on league tables and IPO processes.

- *European Commission consultation on conflicts of laws rules:* The European Commission launched a public consultation on the conflicts of laws rules for third party effects of transactions in securities and claims on 7 April 2017. The consultation questions were principally focused on downstream holdings certainty of title (ie mainly sub-custodians below ICSD accountholders level) and in particular the securitisation and repo markets. ICMA responded with a brief letter to reiterate our position on the holding structure of securities and good discharge concept.

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ECP market

Asset-Backed Commercial Paper (ABCP)

Leaseurope coordinated a, 24 April 2017, joint industry letter on rebuilding Europe's securitisation markets, addressed to the European Commission, the European Parliament and the Council. Of note from an ECP market perspective, section C of this letter (at page 12) is headed "Capital increase for ABCP transactions increases the funding costs of real economy companies". It is highlighted that as most ABCP transactions are senior and of high quality, they are generally not rated sub-investment grade; and that the rating of European ABCP transactions is predominantly based on the internal assessment approach (IAA). It is then illustrated that

Industry strongly recommends postponing finalisation of these step-in risk guidelines until the BCBS' own assessment of the effectiveness of its post-crisis reforms has been conducted.

proposed new risk weights result in a dramatic increase of required capital, thus endangering this form of refinancing for corporates; and, hence, argued that risk weights for simple, transparent and standardised (STS) securitisation transactions should be maintained at the current level.

On 15 May, the IIF, jointly with other trade associations, submitted a comment letter in response to the BCBS's consultative document on the Identification and management of step-in risk. Of note from an ECP market perspective, this comment letter acknowledges that most – if not all – examples of step-in were triggered by short-term funding needs (eg SIVs, ABCP conduits). However, many ABCP conduits and other types of vehicles that were once recipients of off-balance sheet treatment are, following accounting changes, now consolidated on banks' balance sheets; and regulatory reform in many cases now requires full capitalisation of potential exposure to these entities, eg a Credit Conversion Factor (CCF) of 100% applies to liquidity facilities extended to SIVs and ABCP conduits by regulated banks.

Additionally, reputational risk and implicit support already became part of the Supplemental Pillar Two Guidance within the Enhancements to the Basel II framework, with reputational risk arising from "a bank's sponsorship of securitisation structures such as ABCP conduits and SIVs" being explicitly mentioned in this context. Furthermore, the LCR requires banks having structured financing facilities that include the issuance of short-term debt instruments, such as ABCP, to fully recognize the concomitant liquidity risks. Thus, the need for any further measures needs thorough consideration and hence, overall, the industry strongly recommends postponing finalisation of these step-in risk guidelines until the BCBS' own assessment of the effectiveness of its post-crisis reforms has been conducted and evaluated.

On 30 May, it was announced that the European Parliament, the Council and the Commission had agreed on a package that sets out criteria for STS securitisation. This new regulatory framework sets out a risk-sensitive, transparent and prudential treatment of securitisation; and, at the same time, is intended to ensure an appropriate capital treatment of securitisation instruments in general. This political agreement was followed by further technical talks to finalise the texts (as linked in this paragraph), ahead of official endorsement by the Permanent Representatives Committee (COREPER) of the Council of Ministers and of the European Parliament's plenary vote.

Surveying the Scene: Issues for the Global Securitisation Markets, a Client Briefing published by Clifford Chance, on 31 May, includes a specific section on ABCP (on page 8). This highlights a number of concerns relating to the application of the EU's incoming STS securitisation regime, as it applies to ABCP. These may mean that the STS regime will only prove practical for ABCP if and when its requirements are further refined.

Circulated on 31 May, AFME's Q1 2017 *Securitisation Data Report* shows that European ABCP issuance was €82.3 billion in Q1 2017. This is a decline of 12.5% versus the prior quarter and of and 14.1% versus the prior year. Multiseller conduits, particularly from Ireland and France, continue to dominate (88% of total) as the largest category of issuer in the ABCP market.

Money Market Funds (MMFs)

On page 24 of Issue no 44 of the ICMA Quarterly Report there is a short report on specific provisions of the new EU MMF Regulation (MMFR) as they relate to commercial paper. As formally published in the *Official Journal*, dated 30 June, the text of the EU MMFR was subsequently finally signed off by the European Parliament and the Council. This has not changed any of the wording associated with the provisions highlighted in Issue no 44, but has led to renumbering of the referenced Articles.

On 24 May, ESMA launched a related consultation, for comment by 7 August. Of greatest significance from a commercial paper perspective, this includes a section regarding technical advice on "the criteria for the validation of the credit quality assessment methodologies and the criteria for quantification of the credit risk and the relative risk of default of an issuer and of the instrument in which the MMF invests, as well as the criteria to establish qualitative indicators on the issuer of the instrument" – this is the subject of Chapter 4 of the consultation (pages 31-45).

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Primary markets in Asia-Pacific

ICMA facilitates two debt primary market committees in the region, the ICMA Asia Bond Syndicate Forum and the ICMA Asia Legal & Documentation Forum, which allow participants to shape cross-border primary market practices in Asia and provide Asian perspectives on European regulation and practice. Recent topics of interest include X-accounts, primary electronification, allocation practices, and retail distribution. The Asia committees have also discussed the impact of international regulation (particularly MiFID II/R and MAR) and syndication automation technology on the regional market practices.

The Asia Legal & Documentation Forum has developed a draft schedule of the standard Agreement Among Managers (AAM) for use in for transactions documented in Asia where the syndicate and market dynamics in Asia are to be considered; the draft Asia schedule is being applied to transactions in the region (ex-Japan) and is under consideration for inclusion in the Primary Market Handbook.

ICMA continues its partnership in China with the National Association of Financial Market Institutional Investors (NAFMII) to develop the cross-border Chinese debt capital markets. ICMA is currently working with NAFMII to develop a market development toolkit to increase foreign investment in Chinese domestic bond markets through the Hong Kong-Shanghai Bond Connect project and further expand the foreign issuer base in the panda bond market. ICMA delivered a workshop to People's Bank of China on international bookbuilding practices and continues to advise regulators on how to improve Chinese onshore market practice.

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Secondary Markets



by Andy Hill, Elizabeth Callaghan and Gabriel Callsen

MiFID II/R implementation in secondary markets

Introduction

On the whole, MiFID II (the Directive) concerns the framework of trading venues and structure in which instruments are traded. Each EU member jurisdiction can adapt the Directive depending on the structure of the market in the EU Member State in question, when it transposes MiFID II (the Directive) into its national law. MiFIR (the Regulation), on the other hand, concentrates on regulating trading venues and structuring their operations. MiFIR is an EU Regulation, which applies directly – and compliance is mandatory – in all EU Member States. MiFID II covers "who" the different market structures are and "what" they trade, while MiFIR covers "how" they trade.

Regarding trading, the most important obligations are MiFIR's pre- and post-trade transparency regulations and best execution obligations.

Transparency

ICMA fully supports the principle of greater pre- and post-trade price transparency in Europe's fixed income markets, which can help to facilitate price discovery, and so greater market efficiency and liquidity. However, ICMA also recognizes that such transparency can create risks for both liquidity providers and liquidity takers, particularly with respect to less liquid securities or larger than standard-sized transactions. In order to have a well-functioning EU bond market, transparency calibrations and participant obligations need to be appropriately tuned, with liquidity and size of trade logically influencing the level of information published.

MiFID II/R liquidity assessments are dependent on three characteristics: (i) whether the bond is liquid or not (ie whether there is continuous buying and selling interest); (ii) whether there is no undue risk to liquidity providers (below size specific to the instrument (SSTI); and lastly (iii) whether the trade is large in scale (LIS) versus a normal market size trade and could potentially damage the transacting parties.

The liquidity assessments will impact whether there is transparency or not under MiFID II/R. If it is proved that the liquidity profile for a bond or a trade will impact the market negatively, then waivers or deferrals will be put in place and transparency obligations will be delayed or prevented altogether. If there is not a negative impact on liquidity in the market, then transparency obligations will go forward.

Key objectives of bond transparency obligations under MiFID II are to:

- move bond trading practices (currently over the counter (OTC) onto trading venues, such as Organised Trading Facilities (OTFs), Multilateral Trading Facilities (MTFs) and Systematic Internalisers (SIs);
- create a price discovery mechanism in bond markets, by expanding pre- and post-trade transparency requirements to fixed income instruments; and
- increase available reference data for bonds (so that market participants are informed as to the true level of potential transactions).

Pre-trade transparency obligations

- Requirements apply to Regulated Markets (RMs), MTFs, OTFs and SIs.
- Operators must make publicly available, on a continuous basis during trading hours, actionable indications of interest (IOIs): ie current bid and offer prices, and depth of trading interest, including: request for quote (RFQ) systems and voice trading systems.
- Systematic Internalisers (SIs), where they make quotes public, will trade at quote with all clients of the SI, subject to commercial policy (eg transparency limits and size thresholds.)

Pre-trade transparency requirements can be waived for:

- financial instruments for which there is not a liquid market;

- orders that are large in scale (LIS) compared to normal market size;
- orders on RFQ or voice trading systems that are equal to or larger than the relevant size specific to the instrument (SSTI).

Post-trade transparency obligations

- Requirements apply to RMs, MTFs, OTFs, and investment firms trading OTC.
- Investment firms trading outside a trading venue and market operators and investment firms operating a trading venue must make publicly available trade details, including price and quantity.
- Post-trade information must be available as close to real time as possible (15 minutes from execution, up until January 2020, and within 5 minutes thereafter).
- There are no permanent waivers for post-trade reporting, but reporting can be deferred for up to 48 hours in the case where:
  - the transaction is in a security for which there is not a liquid market; or
  - the size of the transaction is equal to or exceeds the relevant large in scale size (LIS).
- National competent authorities can decide that reporting can be further deferred (including aggregation and omission of size), for an extended deferral period of up to four weeks, usually referred to as a "Supplementary Deferral Regime".

Who reports post-trade, publicly, when?

- If executing on a venue – Venue reports (ie the relevant trading platform).
- If executing with an SI – SI reports (eg the market maker).
- If executing via OTC – the selling counterparty reports (whether sell-side or buy-side).

Note: If executing with a non-EU entity, the transaction is considered to be an OTC transaction – the EU entity reports, regardless of whether they are a seller or a buyer.

Best execution

MiFID II/R's best execution requirements (extended from MiFID) are playing a significant role in MiFID II/R. Through MiFID II/R's best execution policy, firms are required to "evidence" best execution and to provide the "best possible result for the client".

Best execution (RTS 27) – reporting criteria for execution venues:

- There is a requirement to provide the public with relevant data on execution quality to help them determine the best way to execute client orders.
- Execution venues including Regulated Markets, MTFs, SIs, OTFs, market makers or other liquidity providers must publish required data in a machine-readable electronic format, quarterly.
- The data should be segregated according to trading systems, trading modes and trading platforms.

Best execution (RTS 28) – quality of execution and top five venues for the buy-side:

- Investment firms (including buy-side firms) should evaluate the quality of their execution practices by identifying and publishing the top five execution venues, in terms of trading volumes where those firms executed client orders in the preceding year.
- Information published should be split between retail client flow and professional client flow.
- In a separate report, investment firms should summarise and make public the top five execution venues where they executed securities financing transactions (including repos).
- Investment firms must publish, for each class of financial instruments, a summary of the analysis and conclusions based on the quality of execution on the execution venues.

New bond market structure emerging from MiFID II

The new trading landscape extends many of the obligations relating to equities under MiFID into fixed income (eg MTFs and SIs). However, the OTF trading venue is new to all asset classes. MiFID II/R has now created a much more prescriptive rules-based market structure in which to trade.

In the new market structure, it is important to distinguish between MTFs, OTFs and SIs:

- *Multilateral Trading Facility (MTF):* A multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments.
- *Organized Trading Facility (OTF):* A multilateral system which is not an RM or an MTF and which brings together multiple third-party buying and selling interests in bonds (also including: structured finance products, and derivatives). Unlike RMs and MTFs, operators of OTFs will have *discretion* as to how to execute orders, subject to pre-trade transparency and best execution obligations.
- *Systematic Internaliser (SI) regime:* An investment firm that deals on its own account by executing client orders outside a trading venue. Its purpose is to ensure that the internalisation of order flow by investment firms does not undermine the efficiency of price formation on RMs, MTFs and OTFs (in short, SIs extend transparency obligations into the OTC space).

There are several points to note about the new market structure:

- RMs and MTFs are not allowed to execute client orders against proprietary capital, or to engage in matched principal trading.
- OTFs may deal on own account, other than matched

principal trading, only with regard to illiquid sovereign debt instruments

- OTFs and SIs cannot exist within the same legal entity, nor connect to enable orders or quotes to interact.

Implementation planning

The January 2018 MiFID II/R implementation date is approaching and market participants are immersed in preparations for MiFID II/R. With this in mind, ICMA will be holding MiFID II/R implementation workshops across Europe. These workshops will assist buy-side and sell-side bond traders in assessing whether they are on the same track as their counterparts in other regions. The workshops will also facilitate discussions on local implementation challenges and interpretations as well as the sharing of information. These workshops are for bond trading participants who are heavily focused on transparency, best execution and the research obligations of MiFID II/R, as well as the newly emerging market structure trends, such as innovative protocols and platforms. Panels will feature international and local experts from the buy side and sell side.

ICMA's MiFID II/R Workshops will be interactive as they will assume an audience with a working knowledge of cash bond trading and MiFID II/R related obligations. Registration for these events can be found on ICMA's event page: https://www.icmagroup.org/events/ . The MiFID II/R Implementation Workshop schedule began in London on 4 July and it is planned to continue in the autumn in Stockholm, Brussels, Frankfurt, Milan, Madrid and Paris.

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M Practical challenges of implementing MiFID II/R in secondary markets

Trading workflow and regional interpretations

It is becoming increasingly evident, and not without some concern, that MiFID II/R is likely to have a dramatic impact on the way trading is currently conducted in the European fixed income markets, influencing not only the way in which firms work their orders and execute their trades, but also where they will choose to trade and with whom. This becomes even more complex given the scope within MiFID II/R for the various jurisdictions to use their individual discretion in how they interpret and apply the rules. Two examples of potential challenges are provided below.

Differing post-trade deferral regimes across regulatory judications in the EU: Under MiFID II/R transparency rules, EU Member States have discretion with respect to the application of the post-trade deferral regime. With respect to large trades, or those in non-liquid securities, each jurisdiction can decide what trade information should be made public, and when, ranging from two days to four weeks after the trade. This creates a potential problem, since both liquidity providers and liquidity takers have a natural incentive to avoid information leakage following large trades, particularly in illiquid bonds, in order to protect themselves or each other from the risks of subsequent adverse market moves. Accordingly, this is likely to drive activity in these trades to jurisdictions with the least conservative deferral regimes. Not only will this fragment bond market liquidity across the EU, it will also create an uneven playing field, disadvantaging investors, liquidity providers and trading venues operating in more conservative jurisdictions.

Breaking the hybrid model of trading: Pricing and liquidity in bond markets are generally provided by market makers, particularly for large trades or less liquid bonds, and, in most cases, buy-side firms will put their orders to a market maker: calling their dealer-banks directly, communicating via electronic messaging, or sending a request-for-quote (RFQ) through a trading platform. Traditionally these firms would provide a price for the client's full order, and, assuming the client is happy with the price, they take the trade onto their books (either going long or short). They will then look to trade out of these positions over the following days or weeks. However, as dealer balance sheets become more constrained, it is now becoming quite common for dealers to offer to work client orders instead; effectively acting as a principal broker. They will look for an offsetting client interest, and then match the client interests, standing as principal intermediary between the two clients. In fact, it is not unusual for market makers to apply a hybrid model of both risk and riskless-principal, taking part of the client order onto their balance sheet, and working the remainder on a riskless-principal basis. This allows clients to keep their entire order with one dealer, so minimising information leakage.

However, MiFID II/R looks set to break this hybrid liquidity model. MiFID II/R makes a clear distinction between risk-principal trading (true market making), which can be carried out by investment firms (most likely to be categorised as Systematic Internalisers), and riskless-principal trading (or "matched principal" trading), which should be carried out by Organised Trading Facilities (OTFs). Importantly, Systematic Internalisers and OTFs cannot operate within the same legal entity, nor interact within the same group. In other words, buy-side firms will be able to get a firm market quote from market makers, but will need to work orders through OTFs. This is likely to create additional challenges for buy-side firms in terms of deciding how best to work their orders, and with whom, not least since they are unlikely to want to split these across multiple counterparties given the risk of information leakage.

ICMA is facilitating ongoing discussions between its active sell-side and buy-side members, interdealer brokers, as well as the regulatory community, in order to highlight and address these potential challenges to bond market functioning.

Governance and compliance

MiFID host governance over third country branches: Where a "host" MiFID firm is located within the EU, but has branches outside of the EU (such as a Singapore branch of a French bank), the branches are required to comply with MiFID II/R. Implementation is likely to be extremely challenging for non-EU branches, particularly with respect to the application of the transparency rules with its various security and instrument level liquidity thresholds and waiver calculations.

Information: In order to comply with MiFID II/R, MiFID firms will require a substantial amount of pre-trade information before they can enter into a transaction. This includes data such as the Legal Entity Identifier of their counterparty, a list of authorized Systematic Internalisers for any instrument they are looking to trade, the relevant transparency deferral regime of their counterparty, whom is responsible for transaction reporting, and whether or not their counterparty is a MiFID firm. This is likely to result in firms having to construct complex information matrices for their potential counterparties in order to inform their trading decisions.

Data

An SI database: It will be important for buy-side firms to know which firms are authorised Systematic Internalisers (SIs) for any instrument they are looking to trade, not least since this will affect the reporting requirements (and who should report). However, ESMA will not support a centralised and up-to-date database of SIs (at the legal entity and ISIN level), which would seem to be the obvious solution. It is expected that the Approved Publication Arrangements (APAs) will collate and maintain this information. However, it is unlikely to be either centralised or widely available.

FIRDS reference database matching for TOTV: MiFIR provides a number of provisions with respect to financial instruments that are determined to be "traded on a trading venue" (TOTV), including pre- and post-trade transparency requirements. For instruments classified as TOTV, which includes derivatives that reference TOTV instruments, trading venues (including SIs) are required to submit instrument reference data to ESMA's Financial Instruments Reference Data Systems (FIRDS). This will require the linking of data feeds between ESMA, the 28 NCAs, and around 300 separate trading venues across the EU. However, the success of the FIRDS infrastructure will rely on exact data matches between all the contributing constituents, raising concerns that many instruments may be forced to trade OTC.

LEIs for third country counterparties: To be able to transact under MiFID II/R, market participants are required to have a Legal Entity Identifier (LEI). This is likely to prove problematic for a number of non-EU counterparties, as well as issuers, who neither have LEIs nor are likely to prioritise attaining them.

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ESMA guidance on implementing MiFID II/R in secondary markets

As the deadline for the implementation of MiFID II and MiFIR on 3 January 2018 is fast approaching, the European Securities and Markets Authority (ESMA) has provided further clarifications during the second quarter of 2017.

The following briefing is designed to provide a non-exhaustive summary of key issues impacting market structure and fixed income trading, notably:

- market structure, the distinction between the newly created category of Organised Trading Facilities (OTFs) and Systematic Internalisers (SIs);
- best execution requirements;
- pre- and post-trade reporting requirements;
- reporting obligations for trades executed outside the EU; and
- the concept of "Traded on a Trading Venue" (TOTV).

MiFID II / MiFIR

Overview of selected ESMA guidance in Q2 2017:

31 May: Q&As on transparency topics

31 May: Opinion on determining third-country trading venues for the purpose of transparency

22 May: Opinion on OTC derivatives traded on a trading venue (TOTV)

5 April: Q&As on market structure topics

5 April: Q&As on transparency topics

4 April: Q&As on investor protection topics

Market structure: riskless or matched principal trading and trading at risk

Organised Trading Facility (OTF)

To increase transparency of over-the-counter trading activity in fixed income, MiFID II introduced the concept of Organised Trading Facility (OTF)[48], a new category of multilateral trading venues.

ESMA further specified the characteristics of OTFs, which consist in the following:

- First, "trading is conducted on a *multilateral* basis". This includes, for instance, "matched-principal trading" (where both sides are executed simultaneously and the facilitator makes no profit or loss other than a previously disclosed fee); *or* riskless principal trading (involving two orders, with the execution of one of these orders dependent upon the receipt or execution of the other); *or* "market-making" provided the investment firm acting as market-maker on the OTF operates on an "independent basis".[49]
- Second, "the trading arrangements in place have the characteristics of a *system*", for instance, "automated crossing of client trading interests" or arrangements used repeatedly.
- Third, "the execution of the orders takes place on a *discretionary* basis".

These provisions apply equally to electronic and voice trading. Importantly, investment firms operating an OTF are required to seek authorisation from their national regulator.

48. MiFID II, Article 4 (1) (23) defines an OTF as "a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds [...] are able to interact in the system in a way that results in a contract [...]".

49. See MiFID II, Article 20 (2) and (5).

Systematic Internaliser (SI)

ESMA furthermore delineated OTFs from the concept of "Systematic Internaliser"[50], a term introduced by MiFID I (2007) and extended to the fixed income space under MiFID II. It is highlighted that a "key characteristic" of an SI is to provide "liquidity *bilaterally* to clients by *trading at risk*".

However, SIs "operating functionally similar to a trading venue" would be classified as such (ie either as MTF or OTF) and should request authorisation if the following criteria are met:

- the SI does not *de facto* undertake risk facing activity, and interaction with clients is not only bilateral;
- transactions are *not ad hoc*, but arrangements are used on a *regular* basis and can be considered "a system or facility"; and
- transactions that result from "bringing together multiple third party buying and selling interests and are executed OTC, outside the rules of a trading venue".

Note: These criteria are not meant to prevent SIs from undertaking hedging activities provided the whole transaction does not result in riskless transactions between third-party buying and selling interests. Hedging on a trading venue is permissible.

An exception consists in the possibility for an SI to undertake matched-principal trading on an "occasional basis" only as opposed to a "regular basis", further to Recital (19) of the Commission Delegated Regulation (EU) 2017/565. The key questions to assess such a scenario are as follows:

- Are systems or arrangements in place designed to match opposite client orders?
- Do non-risk facing activities account for a *recurrent* or *significant* source of revenue for the investment firm's trading activity?
- Does the investment firm *market*, or otherwise *promote*, its matched-principal trading activities?

If the answer to *any* of these questions is "yes", the trading activity is not considered "occasional" and falls under the OTF category.

ESMA stressed that OTF and SI activities must not be undertaken by the same legal entity across asset classes and instruments since MiFID II sets out "a blanket prohibition". In practice, this entails that OTFs and SIs have to be operated as separate legal entities. These may, for instance, operate separately under the umbrella of a group of legal entities. However, even if an OTF and an SI are separate legal entities, they are not permitted to interact.

It is worth noting that the European Commission proposed on 20 June 2017 a MiFIR Level 2 amendment on Systematic Internalisers and riskless principal trading[51], which would apply across all asset classes: "An investment firm shall not be considered to be dealing on own account for the purposes of Article 4 (1) (20) of MiFID II where that investment firm participates in matching arrangements with the objective or consequence of carrying out de facto riskless back-to-back transactions in a financial instrument outside a trading venue". The Commission has requested feedback from industry market participants.

Best execution

MiFID II introduces more stringent requirements in terms of best execution, which are specified in RTS 27 for execution venues and RTS 28 for investment firms.

> #### *Best ex publication timelines:*
>
> **RTS 27:** First quarterly report to be released by 30 June 2018.
>
> **RTS 28:** First annual report to be published by the end of April 2018.

ESMA stated that investment firms may not be able to provide certain data that are unavailable for the first report covering a full calendar year under RTS 28. Firms that are part of a legal or corporate group are required to provide data on their top five trading venues by individual firm rather than combined on a group level.

Regarding Organised Trading Facilities (OTFs), ESMA stressed that a firm's best execution policy should take into account, and also distinguish, orders executed at OTF level and at the investment firm level. In particular, the choice of the execution venue (including on its own OTF), the use of an appropriate protocol (eg voice, RFQ, or order book), and the application of discretion should be addressed.

Pre- and post-trade reporting requirements

Under MiFIR[52], market participants are required to publish information on executed trades via an Approved Publication

50. MiFID II, Article 4 (1) (20) defines a systematic internaliser as "an investment firm which, on an organised, frequent systematic and substantial basis, deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system".

51. Amending Delegated Regulation (EU) 2017/565

52. MiFIR, Article 21.

Arrangement (APA), which is essentially a provider of reporting solutions authorised by a competent authority. Trades executed on a multilateral trading platform – ie a regulated market such as a stock exchange, an MTF such as a specialist bond trading platform, or OTFs such as an interdealer broker – are made public by the respective platform operator.

However, further guidance has been provided on bilateral, OTC transactions. Where an investment firm executes a trade with a client, the reporting obligation lies with the investment firm regardless of whether securities were purchased or sold. However, where a transaction is executed between two investment firms, *only the seller* of the financial instrument is mandated to publish the transaction.

An exception applies to Systematic Internalisers. If an SI acts as the buyer of a financial instrument from an investment firm that is not an SI, the reporting obligation shifts to the SI who has to trade report via an APA. A transaction concluded between two SIs, however, is made public only by the SI acting as a seller according to the established reporting hierarchy.

With respect to "back-to-back" trades, for instance, where one investment firm (A) sells 500k of a corporate bond at 101.20 to another investment firm (B), which the latter (B) then sells on to another counterparty (Z) at the same price, the trade would be considered a single transaction. The initial seller, investment firm (A), would be responsible for publishing the trade via an APA. However, should the price not be identical (eg in case investment firm (B) re-sells at 101.35), *each transaction would have to be reported separately by each respective seller.*

ESMA has further clarified that post-trade reporting of OTC transactions to an APA can be outsourced to a third party. However, full responsibility remains with the investment firm, which has to ensure that the third party informs the APA of applicable transparency requirements. In the same vein, the investment firm is responsible for informing the APA of any applicable post-trade deferrals. Notwithstanding any deferrals, trades should be reported to the APA as soon as technically possible.

Additionally, ESMA has elaborated on the reporting obligation of an SI quoting illiquid instruments as defined in MiFIR, Article 18 (2). Accordingly, an SI is not required to publish quotes or disclose them to other clients, provided a waiver is in place for trades in non-equity instruments which are "Large in scale" (LIS) or above the "Size specific to the instrument" (SSTI) thresholds.

Reporting obligations for trades executed on a third country trading venue

ESMA has clarified the reporting obligation for trades executed outside the EU both in a Q&A and in an Opinion. In brief, bilateral trades executed by EU investment firms on third country trading venues that would *not* be subject to a certain level of post-trade transparency should be made public in the EU through an APA. However, if similar transparency requirements apply, reporting via an EU APA is not required.

This would be the case where *all* of the following conditions are met:

- The third-country venue operates a multilateral system.
- It is subject to authorisation, supervision and enforcement in the third country by a competent authority.
- It is a full signatory to the IOSCO MMoU (multilateral memorandum of understanding).
- A post-trade regime is in place whereby transactions executed on the third-country trading venue are published as soon as possible after the transaction was executed or, in clearly defined situations, after a deferral period.

A list of third-country trading venues that are deemed to be subject to "similar" transparency requirements will be published by ESMA.

The concept of "traded on a trading venue" (TOTV)

The concept of TOTV was introduced in MiFIR, but not defined. MiFIR extends the scope of transparency[53] and transaction[54] reporting requirements to financial instruments that are not only traded on Regulated Markets, but also on MTFs or OTFs. TOTV establishes a set of characteristics based on "reference data" to determine whether a financial instrument is subject to reporting requirements.

The lack of clarity on TOTV has proved to be particularly challenging for OTC derivatives, and ESMA therefore has issued an Opinion to distinguish between OTC derivatives that are in scope and those that are not. *Note: It is clear, however, that for bonds, Legal Entity Identifiers (LEI) will be required to trade on-venue, regardless of the location of the counterparty.*

ESMA has stated that "only OTC derivatives *sharing the same reference data details* as the derivatives traded on a trading venue should be considered to be TOTV." The "same reference data details" in this context means "same values" as specified in the reporting templates in RTS 23 (Regulation (EU) 2017/585), including, for instance the ISIN, full name of

53. Ie quotes and executed trades to be made public, see MiFIR, Articles 3, 8, 10, 11, 18, and 21.

54. ie trades to be reported to a competent authority, see MiFIR Articles 26 and 27.

the financial instrument, and with respect to interest rate derivatives, the reference rate, and fixed or floating rates of each leg.

Note: The reference data, which will be submitted by trading venues to ESMA's FIRDS (Financial Instruments Reference Data Systems), will be subject to reporting and transparency obligations on-venue and will have to be an exact match in order to trade on-venue.

Further information on the implementation of MiFID II/R, including ICMA position papers, briefing notes and related resources, can be found on the ICMA website.

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European Commission Expert Group on Corporate Bond Market Liquidity

In June 2016, the European Commission created an Expert Group on Corporate Bond Market Liquidity. The "Group", consisting of a cross-section of market participants and end-users of financial services, is expected to advise the Commission on its review of liquidity in European corporate bond markets, in the context of the Action Plan on *Building a Capital Markets Union*, with a view to improving the efficiency and resilience of corporate bond markets. Furthermore, the Group is asked to assess the strengths and weaknesses of the emerging market architecture, and its resilience under different scenarios. This includes identifying actions (market-based or policy-led) that contribute to a better functioning of these markets – as a source of funding and investment opportunities – in the context of the new (post-crisis, post-regulatory reform, unconventional monetary policy) financial landscape. ICMA, represented by Andy Hill, is one of the 17 members of the Expert Group.

The eventual output of the Expert Group will be a report to policy makers and regulators that will provide specific and detailed recommendations designed to enhance the effectiveness and liquidity of the European corporate bond markets. The report is expected to be published in October 2017. This is intended to coincide with the publication of an independent report, commissioned by the European Commission, into the drivers of corporate bond market liquidity.

More information on the Expert Group, including public minutes of it meetings, can be found both on the European Commission's website, as well as on the ICMA website.

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ECB Corporate Sector Purchase Programme

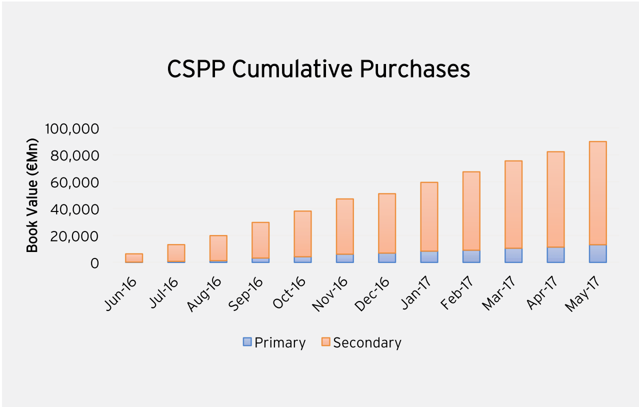
On 21 June 2017, approximately one year after the commencement of its Corporate Sector Purchase Programme (CSPP), the ECB (via Twitter) announced that from 26 June 2017 it would make available on its website a list of its CSPP holdings. On the same day, the ECB also published an update on the implementation and impact of the CSPP.

The key highlights of the update (which is taken from its June 2017 Economic Bulletin), are:

- As of 7 June, CSPP holdings stood at €92 billion, corresponding to around 11% of the CSPP-eligible bond universe.
- Holdings consist of over 950 securities issued by around 200 issuer groups.
- The pace of purchases depends on prevailing market conditions: monthly net purchases during the period from June 2016 to May 2017 ranged between just below €4 billion and €10 billion.
- Since its inception, 15% of holdings have been purchased in the primary market.
- Investor demand for CSPP-eligible corporate bond issuance was, on average, around three times the issued amount.
- Euro area corporate bond yields declined in the period following the announcement (March 2016) until the autumn of 2016, when they increased in light of new supply and a global rise in risk premia. Since the beginning of 2017, overall yields have declined again, amid relatively low volatility.
- Market liquidity conditions remain generally favourable for CSPP bond purchases.
- Financing conditions for companies have improved: market participants mention the CSPP as a factor that has supported the ability of companies to issue bonds and deepened the corporate bond market.
- The annual growth rate of corporate bond issuance has generally increased since spring 2016 and reached around 10% in the first months of 2017.
- The CSPP has also benefited companies which do not rely on capital markets for their financing, particularly with respect to SMEs.

ICMA continues to work closely with its members to monitor the ongoing impacts of the CSPP on corporate bond market functioning and liquidity, as well as staying in contact in with the ECB. Previously the ECB has attended two meetings of ICMA's Secondary Market Practices Committee (SMPC) to discuss and exchange views with market practitioners on the implementation and impacts of CSPP.

ECB CSPP Cumulative Purchases as of end of May 2017



Source: ECB

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CSDR settlement discipline

In May 2017 ICMA published a position paper on CSDR Settlement Discipline. The paper was prepared in close consultation with the SMPC CSDR/Buy-in Working Group, as well as with the SMPC, ERCC, and AMIC. Essentially, ICMA proposes that the cash penalties for bonds should be increased when implemented in 2019, while mandatory buy-ins should not be implemented.

In principle, ICMA is supportive of the cash penalty regime, particularly to the extent that it is fully harmonised, utilises a single reference price for each security, and consists of both a penalty and compensation component. ICMA believes that a cash penalty regime for fails is particularly relevant in a negative or low interest rate environment, when the normal economic incentives for settlement efficiency become less effective. However, the potential effectiveness of a penalty regime rests not only on its design, but also on the penalties being applied, particularly with respect to the prevailing interest rates. ICMA considers that the penalty rates currently proposed in CSDR for bonds (0.1bp SSA and 0.2bp for non-SSA, per business day – approximately 0.25% and 0.50% annualized) are too low to be effective, particularly with respect to "specials" rates observed in the repo market, or the costs of utilizing the ICSD "autoborrow" facilities. ICMA proposes the penalty rate be increased to 1bp (approximately 2.50% annualized) for all bonds (except SME debt instruments). This penalty rate should be reviewed on a periodic basis in light of settlement efficiency rates as well as prevailing interest rates.

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It is ICMA's belief that the design of the buy-in regime is inherently flawed.

ICMA, however, remains firmly opposed to the implementation of the CSDR buy-in regime with respect to the European non-centrally-cleared fixed income markets. It is ICMA's belief that the design of the buy-in regime is inherently flawed, that it creates unnecessary and unintended risks for both sellers and buyers, and that its implementation will be a direct threat to the orderly and efficient functioning of the European bond markets. ICMA therefore believes that the implementation of the mandatory buy-in regime should only be considered if an appropriately calibrated penalty regime proves ineffective in improving and maintaining bond market settlement efficiency.

While the RTS for cash penalties were published in the *Official Journal* in March 2017, the draft RTS for mandatory buy-ins, published in February 2016, have still not been agreed by the European Commission and the co-legislators. However, it is expected that this should happen by the end of Q3 2017. The full CSDR settlement discipline package will then come into force 24 months from this date.

In the meantime, a number of cross-industry initiatives are in place which are trying to tackle the significant technical challenges of implementing both the cash penalty and mandatory buy-in regimes. ICMA will continue to engage in these various workstreams, particularly with respect to the implementation of the mandatory buy-in regime for non-cleared bonds. However, while doing so ICMA will continue to press its position that mandatory buy-ins should not be implemented, and that there are far more constructive, less harmful measures to support settlement efficiency, including a recalibration of the cash penalty mechanism.

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ICMA Secondary Market Practices Committee

On 2 May 2017, the ICMA IG Corporate Bond Secondary Market Practices Committee (SMPC) met in London. The SMPC is an open forum for sell-side and buy-side member firms active in the European investment grade corporate bond secondary market. Through open dialogue and engagement, as well as through its subsidiary working groups and workstreams, it seeks to be the representative body of the European corporate bond secondary market: addressing practical issues directly relevant to market practitioners; standardising market best practice; disseminating relevant market information; and promoting the best interests of an efficient and liquid market. It is co-chaired by Sonali Das Theisen of Citigroup Global Markets and Yan Couellan of AXA Investment Managers.

At the 2 May meeting, Stephen Hanks, Manager, Markets Division, of the UK's FCA was invited to join as special guest to discuss with members outstanding issues related to the implementation of MiFID II/R with respect to fixed income markets, in particular corporate bond markets. Topics covered included concerns over the post-trade transparency deferral regimes, thresholds for liquid and illiquid bonds, the practicalities of the Systematic Internaliser regime, challenges with reporting requirements, the definition of "traded on a trading venue", best execution obligations, and the disclosure of costs and charges.

Other topics discussed by members in the meeting included the ongoing market effects of the ECB's Corporate Sector Purchase Programme, the impacts of the recent changes to the ICMA buy-in rules, ICMA's work with respect to Asian corporate bond secondary markets, ICMA's forthcoming study on the European credit repo market, and a roundup of key regulatory initiatives.

The minutes of the meeting will be made available on the SMPC webpage following the next meeting, which is likely to be held in the first week of September. Any members interested in participating in future SMPC meetings should contact its secretary, Andy Hill.

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Repo and Collateral Markets

by David Hiscock, Alexander Westphal and Andy Hill

MiFID II/R implementation: securities financing transactions

Introduction

There are a number of areas where securities financing transactions (SFTs), including repos and securities lending transactions, are explicitly or potentially implicitly in scope of MiFID II/R. ICMA has focused its advocacy efforts where the regulatory requirements are ambiguous, disproportionately burdensome on SFT liquidity providers and users, or simply inappropriate. In particular, ICMA has focused on:

- transaction reporting;
- pre- and post-trade transparency; and
- best execution reporting.

Since September 2016, ICMA has maintained an FAQ on MiFID II/R and SFTs on its website aimed at keeping members informed of the relevant issues and ongoing developments.

Transaction reporting

RTS 22 of MiFID II/R provides a specific exclusion for transaction reporting for SFTs where these are already in scope of the transaction reporting requirements of EMIR and SFTR. However, the notable exception to this exemption is with respect to SFTs transacted with central banks in the European System of Central Banks (ESCB), and these are in scope of the transaction reporting requirements of MiFID II/R. ICMA has advocated that this is unnecessary, and that SFTs with ESCB central banks should also be exempt. ESMA and the European Commission did not agree. However, they did agree that MiFID II/R transaction reporting for these SFTs would not be required until SFTR reporting comes into effect (so avoiding the necessity for firms to build separate reporting functionality).

Pre- and post-trade transparency

MiFID II/R was ambiguous with respect to the pre- and post-trade reporting and SFTs. ICMA advocated that SFTs should not be subject to pre- and post-trade transparency obligations. On 30 June 2016, an agreed amendment to MiFID II/R was published in the *Official Journal* that included an exemption for SFTs under Article 1 relating to pre- and post-trade transparency obligations.

Best execution reporting requirements

RTS 27 outlines the reporting requirements for trading venues, including Systematic Internalisers, market makers, and other liquidity providers, to evidence that they have taken "all sufficient steps" to obtain the best possible result for the client when executing orders. Trading venues (Regulated Markets, Multilateral Trading Facilities, Organized Trading Facilities), Systematic Internalisers, market makers, and other liquidity providers are required to make available to the public (in machine-readable electronic format), at no charge, data relating to the quality of execution of transactions on that venue on a quarterly basis. Reports should include details about the price, costs, speed, and likelihood of execution for each individual financial instrument. There are nine separate – and in many cases highly detailed – reporting templates, which apply to each single instrument, per trading day.

Until July 2017, there had been no official guidance on whether SFTs should be reported under RTS 27, or, in the event that they should, how this could be achieved in a clear, consistent, and meaningful way. ICMA has maintained that RTS 27 should not be applied to SFTs, since it would be unnecessarily onerous to comply with the reporting requirements, and the resulting data produced by banks would be meaningless at best, and misleading at worst.

ICMA first wrote to the European Commission outlining its concerns and the need for urgent clarification in October 2016. In January 2017, ICMA published a discussion paper which details the challenges and impracticalities of applying best execution reporting requirements to SFTs. At this time ICMA again reached out to the Commission, along with the FCA, and ESMA.

On 10 July 2017, ESMA published guidance with respect to RTS 27. ESMA clarified that, while best execution requirements apply to investment firms when carrying out SFTs, ESMA considers that the best execution reporting requirements set out in RTS 27 should not apply to SFTs.

RTS 28 specifies reporting requirements for investment firms executing client orders related to the details and quality of execution for each class of financial instrument on their top five execution venues (including Systematic Internalisers, market makers, and other liquidity providers) in terms of trading volumes. Data includes the identity of the trading venues, volume and number of transactions (disaggregated by types of order), as well as a summary of analysis and conclusions drawn by the investment firm from their "detailed monitoring of the quality of execution obtained on all client orders". Investment firms are required to report information on an annual basis, using specified templates. Data related to SFT client orders are required to be reported separately from client order flow in non-SFTs.

Members have questioned the value of RTS 28 with respect to SFTs, and ICMA flags the potential drawbacks in its discussion paper. However, SFTs are explicitly provided for in the RTS, and ESMA has clarified that SFTs are in scope of the reporting obligations.

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European repo and collateral market developments

Liquidity Coverage Ratio (LCR)

On 24 February 2017, the BCBS issued a second set of frequently asked questions and answers (FAQs) on Basel III's Liquidity Coverage Ratio (LCR), responding to a number of interpretation questions received by the BCBS in relation to the January 2013 publication of the LCR standard. Compared to the set of NSFR FAQs previously issued, in April 2014, this new set of FAQs includes, among others, new items in relation to:

- secured transactions collateralised by a pool of assets;
- secured funding – scope of application; and preferential run-off rate;
- collateral treatment;
- excess collateral;
- secured lending transactions – reuse of the collateral to cover a customer's short position; and reuse of the collateral in a repo transaction with collateral substitution right;
- received collateral used to cover short positions;
- ability to return collateral; and
- adjustment of HQLA – relevance of rehypothecated collateral for the unwind mechanism.

Money Market Funds' Regulation

On page 42 of Issue no 44 of ICMA Quarterly Report there is a short report on specific provisions of the new EU MMF Regulation as they relate to repo. As formally published in the *Official Journal,* dated 30 June, the text of the EU MMFR was subsequently finally signed off by the European Parliament and the Council. This has not changed any of the wording associated with the provisions highlighted in Issue no 44, but has led to renumbering of the referenced Articles.

On 24 May, ESMA launched a related consultation, for comment by 7 August. Of greatest significance from a repo perspective, this includes a section regarding technical advice on "the liquidity and credit quality requirements applicable to assets received as part of reverse repurchase agreements". This is the subject of Chapter 3 of the consultation (pages 14-30). This describes different options for both credit and liquidity requirements and identifies ESMA's currently preferred options.

Secured benchmarks/indices

On 15 June, an important market consultation was published by the European Money Markets Institute (EMMI), in relation to their ongoing work on a new transaction-based repo index for euro-denominated debt. The ICMA ERCC has been a strong supporter of this EMMI project since its inception. Two members of the ICMA ERCC Committee were also members of the Joint Task Force that explored the feasibility of the new repo index, actively contributing to that work and regularly reported back to the ICMA ERCC Committee. Many other bilateral contacts were had with EMMI colleagues, who provided regular updates of their work at the meetings of the ICMA ERCC – most recently at its 2017 AGM, held on 20 March, in Zurich.

The ICMA ERCC believes that a successful launch of the new repo index as a market wide tool would open many interesting opportunities for the wider financial community. Appropriate market feedback will be critical to make sure that the new index can meet these expectations. Accordingly, the ICMA ERCC is encouraging all its members to carefully review the proposals and to submit their comments by the, 14 July, deadline.

CCP regulation and supervision

On 13 June, the European Commission put forward a proposal for more robust supervision of CCP activities in the EU, based on an assessment of the existing supervisory arrangements for CCPs as well as on feedback from a series of public consultations. The proposal introduces a new "two tier" system for classifying third-country CCPs. Non-systemically important CCPs will continue to be able to operate under the existing EMIR equivalence framework. However, systemically important CCPs will be subject to stricter requirements. Depending on the significance of the third-country CCP's activities for the EU and Member States' financial stability, a limited number of CCPs may be of such systemic importance that the requirements are deemed insufficient to mitigate the potential risks. In such instances, the Commission, upon request by ESMA and in agreement with the relevant central bank, can decide that a CCP will only be able to provide services in the EU if it establishes itself in the EU.

The concerns underlying this new proposal have been principally related to the systemic importance of London-based CCP clearing of euro-denominated derivatives business. Yet, CCP clearing is also important for European repo business, the majority of the volume of which is voluntarily CCP cleared, and the European repo/collateral market will be impacted in case there is a significant increase in aggregate margining requirements as a result of changes to the CCP clearing of derivatives. ICMA, consistent with its mission to promote resilient and well-functioning international debt capital markets in support of economic growth, consistently highlights the importance of avoiding any unnecessary market disruption and/or fragmentation. The implications of this CCP clearing proposal for the repo/collateral market need to be carefully considered by officials in light of this overall ICMA objective, while at the same time they seek to conclude which measures must be officially adopted in order to sufficiently ensure essential market stability.

Macroprudential considerations, shadow banking and further potential reforms

Published on 12 April 2017, *Repo Market Functioning* is a report prepared by a Study Group established by the CGFS and chaired by Sir Jon Cunliffe, Bank of England. Recognising that repo markets play a key role in facilitating the flow of cash and securities around the financial system, the CGFS Study Group on repo market functioning analysed changes in the availability and cost of repo financing, and how these affect the ability of repo markets to support the financial system, both in normal and stressed conditions – focusing on repo transactions backed by government bonds. The Study Group finds that repo markets are in a state of transition and

UK Money Markets Code

On 26 April 2017, the Bank of England posted on its website a new UK Money Markets Code, which has been endorsed by the Money Markets Committee of the Bank. The Code is accompanied by an Explanatory Note.

This Code sets out the standards and best practice expected from participants in the deposit, repo and securities lending markets in the UK. It supersedes guidance for participants in these markets provided by the NIPs Code, the Gilt Repo Code and the Securities Borrowing and Lending Code. By bringing these together it will more clearly establish the framework for transacting in UK money markets. The high standards which the Code promotes are intended to build greater trust and certainty throughout these markets, which would bring clear benefits for all involved.

This new Code remains voluntary but the Bank is encouraging all market participants to follow its guidance. A standardised Statement of Commitment to the Code is provided in Annex 1 and the Bank's ambition is for the Code to be embedded widely by the beginning of 2018.

The Code's overriding principle is for UK market participants to always act in a manner to promote the integrity and effective functioning of the markets. It sets out six underpinning principles in order to promote an open, fair and effective market. These are detailed in Chapter 1, Background and Key Principles; and in Chapter 3, Repo, the Code further sets out a summary of the basic procedures which participants in the repo market should observe as a matter of best practice (Chapter 2 relates to Unsecured Money Markets and Chapter 4 to Securities Lending).

This high level Code is different in nature from, but complementary to, the general recommendations laid out in the ICMA ERCC Guide to Best Practice in the European Repo Market, which provides the market with technical guidance that is widely utilised and which the ICMA ERCC will continue to periodically amend for the benefit of its members. ICMA, consistent with its general support for codes of conduct which can enhance the functioning of capital markets, encourages all UK market participants to follow the UK Money Markets Code's guidance as applicable.

> **The implications of this CCP clearing proposal for the repo/collateral market need to be carefully considered by officials.**

differ across jurisdictions in terms of both their structure and their functioning. Underneath the relative stability in headline measures of activity and pricing, there are signs of banks being less willing to undertake repo market intermediation, compared to the period before the crisis; and that the volatility in prices and volumes around balance sheet reporting dates can be associated with banks in some jurisdictions contracting their repo exposure in order to "window dress" their regulatory ratios.

The report identifies several drivers behind these changes including exceptionally accommodative monetary policy, which provided ample central bank liquidity to the market and reduced the need for banks to trade reserves through the repo market, and changes in regulation, which have made intermediation costlier in terms of regulatory capital. Considered from the narrow perspective of repo markets, the balance between the costs and the benefits of these changes is unclear and differs across jurisdictions; and the effect of market adaptations will require more time to mature. Measures that have been adopted by some central banks to reduce the scarcity of certain repo collateral, and others initiated in certain jurisdictions with the objective of facilitating monetary policy, have improved repo market functioning.

Macroprudential Policy in a Changing Financial System is the title of remarks by Vítor Constâncio, Vice-President of the ECB, at the second ECB Macroprudential Policy and Research Conference, in Frankfurt on 11 May. This reiterates the Vice-President's concerns about repos and his view that there need to be further controls over repo activities. Such official commentary continues to leave the ICMA ERCC concerned that there is an insufficient appreciation regarding the role of repo in the real economy, the well-being of which is underpinned by short-term funding. The smooth availability of such funding is essential to facilitate the safe management of fluctuating daily financial obligations – the challenge of which is amplified by the G20's goal of moving to full margining of derivatives. Without fluid repo markets, needed to smooth the interplay of cash and collateral, the framework underpinning the movement of collateral for daily margining will freeze, compromising efforts to ensure a robust financial system. The ICMA ERCC considers that current attempts to re-calibrate constraints on the use of SFTs should be actively pursued, rather than curtailed as some policy makers are suggesting.

Published on 8 May, *Collateral Reuse and Balance Sheet Space* is an IMF staff working paper, in which the author examines the fact that transactions on wholesale capital markets are often secured by marketable collateral. However, collateral needs balance sheet space to move within the financial system and certain new regulations that constrain private sector bank balance sheets may have the effect of impeding collateral flows. The author considers this may have important consequences for monetary policy transmission, for short-term money market functioning, and for market liquidity. In this context (and in contrast to the literature, which has focused mainly on the repo market), this paper analyses securities-lending, derivatives, and prime-brokerage markets as suppliers of collateral. It highlights the incentives created by new regulations for different suppliers of collateral; and, moreover, it argues that central banks should be mindful of the effect of their actions on the ability of markets to intermediate collateral.

On 24 May, the ECB published its latest semi-annual Financial Stability Review (FSR), which provides an overview of the possible sources of risk and vulnerability to financial stability in the euro area. Overall, the ECB reports that:

- repricing risks in fixed income markets remain significant;
- market pressure on euro area banks has receded amid persisting structural vulnerabilities;
- continued political uncertainty and potentially higher bond yields could trigger renewed debt sustainability concerns; and
- Brexit is not expected to pose significant financial stability risk to the euro area (see Box 1: Preparing for Brexit to secure the smooth provision of financial services to the euro area economy – at page 27).

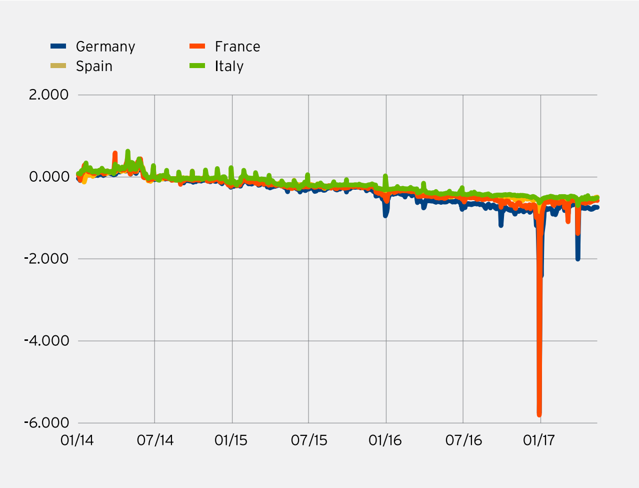
From a repo/collateral market perspective, it is important to note pages 59-60, where there are paragraphs which start:

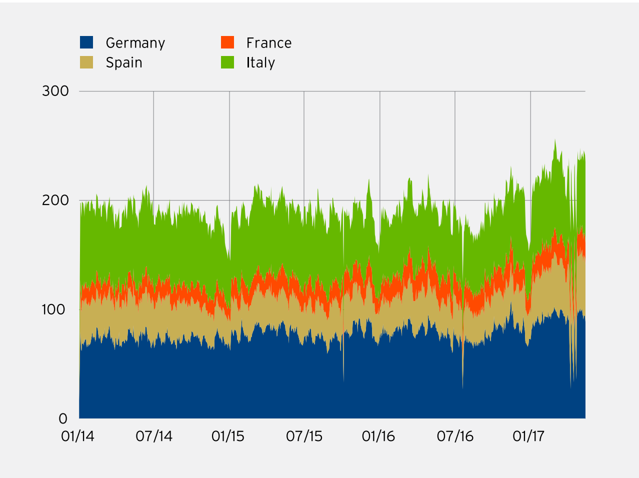
- repo rates declined to unprecedentedly low levels amid low trading volumes at year-end;
- general "window-dressing" activities, as well as regulatory requirements and levies that are calculated based on year-end balance sheet size, may have also contributed to the significant drop in repo rates and volumes around year-end; and
- the evolution of overall repo market trading volumes and significantly lower volatility of repo rates at end-March 2017 suggests that repo market functioning is generally not impaired.

This commentary is supported by the following charts:

Lower repo rates and volumes around reporting dates

Repo funding rate and volumes for Germany, France, Spain and Italy. (1 Jan. 2014 – 16 May 2017; daily data, percentages per annum (top panel) and € billions (bottom panel))





Sources: BrokerTec and MTS

On 29 May, the ESRB published the second annual EU Shadow Banking Monitor, which presents an overview of developments in the European shadow banking system to identify risks to financial stability. The assessment presented in this year's report shows that the growth in broad EU shadow banking assets slowed markedly in 2016. In addition, the report highlights several risks and vulnerabilities which need to be monitored in the EU shadow banking system including, amongst others, procyclicality, leverage and liquidity risk created through the use of derivatives and SFTs. Also on 29 May, the Chair of the ESRB, Mario Draghi, gave an overview of the risks highlighted by the *EU Shadow Banking Monitor* whilst speaking at a hearing before the European Parliament's ECON Committee.

Within this report, from a repo/collateral market perspective, it is worth noting:

- In the Executive Summary, the penultimate paragraph on page 3, which starts: "The build-up of synthetic leverage by non-bank financial institutions and the use of securities financing transactions (SFTs) can facilitate credit growth and maturity and liquidity transformation outside the banking system."
- In the Section 1 Overview, the paragraphs on page 8, which start: "SFTs can be used to build up leverage, where borrowing constraints tend to be inherently procyclical"; "Margining and haircut practices in SFT markets – while mitigating counterparty risk – can expose market participants to funding liquidity risk"; and "The reuse of cash and non-cash collateral can involve liquidity and maturity transformation and increase interconnectedness through collateral intermediation."
- In Section 3 "Activity-Based Monitoring", the introductory paragraphs on page 31, which starts: "From a shadow banking perspective, the main risks and vulnerabilities arise through the use of derivatives and SFTs to build up leverage among non-bank financial institutions"; and "Risk assessments of derivatives markets and SFTs will benefit from new EU-wide supervisory data."
- The whole of Section 3.2 "Securities financing transactions", on pages 35-37.
- In the Section 4 Statistical Overview, Charts 35-45, on pages 47-49.

On 12 June, the US Department of the Treasury issued its first in a series of reports to President Trump examining the US financial regulatory system and detailing executive actions and regulatory changes that can be immediately undertaken to provide much-needed relief. Among the many recommendations for regulatory reform, the Executive Summary includes mention of the following points which, if adopted, would be of significance for the US repo market:

- The scope of application of the LCR should be considerably narrowed to include only internationally active banks; the domestic implementation of the NSFR and the FRTB rules should be delayed until they can be appropriately calibrated and assessed; and US regulators should also rationalise and improve the risk-based capital regime over time through, eg, reducing redundant calculation approaches and improving risk sensitivity in the measurement of derivative and securities lending exposures.
- Consideration of adjustments to the Supplementary Leverage Ratio (SLR) and enhanced Supplementary Leverage Ratio (eSLR) is important to address unfavourable impacts these requirements may have on market liquidity and low-risk assets. Specifically, adjustments should be made to the calibration of the eSLR buffer and the leverage

exposure calculation. Exceptions from the denominator of total exposure should include: (1) cash on deposit with central banks; (2) US Treasury securities; and (3) initial margin for CCP cleared derivatives.

In July 2016, the UK FPC recommended to the UK PRA that when applying its rules on the leverage ratio the PRA considers allowing firms to exclude from the calculation of the total exposure measure those assets constituting claims on central banks, where they are matched by deposits accepted by the firm that are denominated in the same currency and of identical or longer maturity. In response, the PRA invited firms to apply for a temporary rule modification in order to allow the exclusion of claims on central banks from the total exposure measure used to calculate UK leverage ratio capital requirements. The FPC recognised that, absent offsetting the impact of this change, excluding central bank reserves from the exposure measure – the denominator of the leverage ratio – mechanically reduced the amount of capital needed to meet leverage ratio capital requirements at the time, other things being equal. This was not the FPC's intention. It therefore said that it intended to recalibrate UK leverage ratio capital requirements to offset this impact, which the PRA welcomed.

On 27 June 2017, the FPC and PRA launched a new consultation (for comment by 12 September) on changes to the UK leverage ratio framework, relating to the treatment of claims on central banks. In brief, this proposes to make the temporary exclusion of central bank claims permanent, while increasing the minimum leverage ratio requirement from 3.0% to 3.25% of total exposures

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SFT Regulation

On 31 March 2017, ESMA published its final draft regulatory and implementing technical standards (RTS and ITS) in relation to the EU SFT Regulation (SFTR). The technical standards set out the details of the extensive reporting regime for repos and other SFTs which will be introduced by the law. The draft standards are now being reviewed by the European Commission. Once adopted, banks and other investment firms will have another year to prepare before the actual reporting goes live, currently expected in the first half of 2019.

As compared to previous proposals, ESMA's final draft standards include a number of helpful changes which will relieve some of the pain points for reporting firms. ESMA took on board several comments raised by the ERCC and other industry stakeholders during the two public consultations that ESMA undertook after the law itself was adopted by legislators in December 2015. Improvements have been made

Autumn 2017 ICMA ERCC General Meeting

The ICMA ERCC was established by ICMA in 1999 to provide a forum for practitioners in cross-border repo to discuss ways of enhancing the functioning of this pivotal financial market and to consult with market users, infrastructure-providers, policy-makers and regulators. The ERCC hosts two General Meetings each year.

The next ERCC General Meeting, which is being held in Brussels on 14 November, will be used as an opportunity to deepen the exchange of ideas between the market, the public sector and academia at this critical time in the post-crisis programme of regulatory reform. Between keynote addresses from the IMF – Mahmood Pradhan (Deputy Director, European Department) and the ECB – Benoît Cœuré (Member of the Executive Board), there will be two panel discussions, involving industry representatives, regulators and academics. These panel discussions will address general market conditions and operational challenges affecting the effectiveness of repo markets and their macro-financial implications on the path towards greater financial integration across Europe, while making clear the valuable and important role of the repo market at the heart of a collateralised financial market system.

This event is hosted in conjunction with the Euroclear Collateral Conference 2017. Admission to the ERCC General Meeting is open to all ICMA members and to interested financial market participants, free of charge; however registration in advance is essential.

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for instance in relation to the timing of the reporting. In the final proposals ESMA acknowledged that information on the underlying collateral of an SFT is in many cases, eg tri-party business, only available upon settlement. This information is therefore now required on settlement date + 1 at the latest, instead of trade date + 1 as previously suggested. A similar delay has been granted for the daily reporting of collateral reuse, a particularly problematic aspect of the reporting regime.

One of the key implementation challenges remains the reconciliation of reports. Given the double-sided nature of the SFTR reporting, both sides of the report will have to be matched, within and across trade repositories (TRs), where necessary. Some improvements have been made in this regard. In particular, ESMA has introduced an element of phasing in, which would reduce the number of fields that will have to be reconciled for each repo trade to 47 in a first stage – obviously still a very considerable number. This will then be increased to 61 in a second stage within two years.

In order to tackle the specific reconciliation challenge as early as possible and to reduce the likely operational burden resulting from unmatched trade reports, the ERCC SFTR Task Force has launched a bilateral SFTR reconciliation exercise for repo and buy/sell-back trades. A guidance document has been produced as a basis for the exercise, which was circulated to all ERCC member firms and published on the ICMA website on 2 June. The main aim of the exercise is to identify among all the reporting fields put forward by ESMA in the final draft RTS those fields (and transaction types) that are most likely to cause problems in terms of reconciliation. Based on the outcome of the exercise, the ICMA ERCC aims to undertake further targeted industry work to develop additional guidance and market practices for critical reporting fields and transaction types, where necessary, to avoid excessive operational burden in the future.

It is clear that for the SFTR implementation to be successful, collaboration is not only required between market participants but also needs to extend to other players in the market, particularly TRs and third party vendors. Both TRs and vendors are expected to play a critical role in the reporting process. In particular, emerging SFTR solutions that are being developed by vendors are raising expectations in the industry, especially among smaller reporting counterparties, as it is hoped that these tools will help firms to complete the reports, automate the reporting process and achieve a significantly higher level of pre-matching than is currently the case. The ERCC SFTR Task Force has started reaching out to all the vendors in the SFTR space and is hoping to engage in more detailed discussions after the summer.

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Repo markets in Asia-Pacific

In Asia-Pacific, ICMA retains its focus on developing efficient and well-functioning repo markets in the region. In particular:

- ICMA has undertaken to extend the ERCC European Repo Survey to Asia-Pacific markets, in partnership with Asia Securities Industry and Financial Markets Association (ASIFMA). For initial purposes of the survey, Asian repo has been defined as repos (i) involving at least one party dealing in a location in Asia or (ii) in an Asian currency or against collateral issued in Asia.
- ICMA is advising Chinese and Hong Kong institutions, such as China Central Depository and Clearing (CCDC), China Foreign Exchange Trade System (CFETS), Shanghai Clearing House, and Hong Kong Securities and Futures Commission on international repo market practices, documentation, and governance.
- ICMA continues to be active promoting GMRA and international standards in southeast Asia, through regular contacts with local member firms, securities regulators, and central banks. In particular, Indonesia, Malaysia, and the Philippines have recently introduced regulations or guidelines for the use of GMRA by local repo market participants.
- ICMA has played a leading role in the Asia Pacific Financial Forum's workstream on Financial Market Infrastructure, with a focus on regulatory reform and market infrastructure development for Asian repo.
- ICMA has joined the Asia Prime Collateral Forum, an initiative sponsored by the Asian Development Bank intended to facilitate cross-border flow of highly rated Asian domestic currency collateral.

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Asset Management

by Patrik Karlsson and Bogdan Pop

MiFID II implementation: research unbundling

With the MiFID II application deadline less than six months away, investors are actively trying to figure out the best way of adapting to the new EU research unbundling rules and their implementation in various Member States.

Recent consultation papers have shown some divergence in how the FCA and the AMF are intending to implement the framework nationally. On 3 July 2017, the FCA published its final rules. Firms will need time to consider them before committing to an approach with respect to paying for research. ESMA is also reportedly developing further Level 3 guidance to help Member States and firms implement the rules.

As covered in previous Quarterly Report articles, "minor non-monetary benefits" will still be allowed, which include "short-term market commentary on the latest economic statistics or company results" or "information on upcoming releases or events". However, there is divergence in the treatment of corporate access.

Once a firm has formally decided how to implement the new rules, it is difficult to change direction. This is a reason why investors prefer to wait until the final national rules are in place before committing early.

Given the continuing importance of this topic to AMIC members, research unbundling has been raised at the two most recent AMIC Executive Committee meetings. At the 1 March 2017 meeting, the Executive Committee asked the AMIC Secretariat to start developing a survey for members about how they are implementing research unbundling, with expectations that this will be released once the national frameworks are finalised and firms had time to consider them, which is envisaged to be after the summer break.

Most recently, at the 7 June meeting, the AMIC Executive Committee asked the AMIC Secretariat to prepare a briefing note outlining the results of existing surveys on research unbundling and identifying key elements which should appear in the AMIC survey later in the year.

Preliminary findings of the briefing into research surveys show that:

- up to a third of buy-side firms are still undecided on how they plan to pay for research under the new rules;
- a varying number between 33% and 64% of firms are looking to use a Research Payment Account (RPA) model funded by a charge alongside execution commissions – this arrangement will only be possible for equity research;
- between 19% and 30% of firms are actively considering paying for the research themselves and not passing the costs on to clients;
- firms expect research budgets to stay the same or go down in the near future; and
- US firms expect to be impacted by the new rules and a majority will respond by unbundling all their brokers globally.

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STS securitisation

The European Parliament and EU Council reached a trilogue agreement on the simple, transparent and standardised (STS) Securitisation Regulation on 30 May 2017. Following technical discussions to iron out all the details, a consolidated text was published on 26 June.

The AMIC Securitisation Working Group met on 27 June to examine the outcome and to consider next steps. The Working Group noted that, upon initial analysis, the final outcome seemed like a good result for investors in many ways. The AMIC Working Group noted the following highlights:

- Previous wording on restricting investors to only those established in the EU was deleted in favour of an article on restricting selling securitisations to retail clients.
- Unfortunately, the Regulation introduces restrictions on EU investors' ability to invest in non-EU securitisation, because investors must certify that the issuer has retained 5% risk in accordance with this EU Regulation.
- Risk retention remains at 5%, subject to a review by the ESRB.
- The securitisation repository registration process is much curtailed from the Parliament's original plans, and data held by the repository will only be made available to regulators, central banks and investors/potential investors.
- The third-party certification regime follows the Council's original proposal, which was AMIC's preferred approach.
- The EBA must submit a report on synthetic securitisations as STS and the Commission has to act on the EBA's report.
- The review of the Regulation (three years after entry into force) must consider the possible need for a third country equivalence regime to be introduced.
- The date of application will be 1 January 2019.

Now that the lengthy legislative process is finalised, attention turns to the practical implementation of the rules. The European Commission should now be able to launch amendments to Solvency II to introduce lower capital charges for STS securitisation. AMIC will also aim to raise awareness of the new rules among investors.

The AMIC Securitisation Working Group also examined the proposal in the review of the European Market Infrastructure Regulation (EMIR II) to designate Securitisation Special Purpose Entities (SSPEs) as financial counterparties for the purposes of clearing and margining of OTC derivatives.

On STS securitisation, the final outcome seemed like a good result for investors in many ways.

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Covered bond harmonisation

On 8 June 2017, the European Commission announced its adoption of the Mid-Term Review of its Capital Markets Union (CMU) Action Plan, which reports on the progress made so far and identifies a number of new initiatives to revamp the key regulatory reform programme to meet new challenges. It reports that good progress has been made in implementing the 2015 Action Plan, with around two-thirds of the 33 actions delivered in 20 months; identifies significant outstanding measures that will be unveiled in the coming months, along with the timeline for these; and reinforces the initial Action Plan with nine new priority actions.

As expected, the Commission noted that, of the outstanding measures from the 2015 CMU Action Plan, the Commission would quickly move forward with three legislative proposals, which are central to the development of CMU. Besides legislative proposals on pan-European private pensions, securities laws, the Commission also says it will launch a proposal on covered bonds in Q1 2018. The Commission said this should aim to create a more integrated covered bond market in the EU, without undermining the quality of existing covered bonds; and noted that covered bond markets are an important channel for the long-term financing of the real economy. In parallel, the Commission will explore the possibility of developing European Secured Notes (ESNs) as an instrument for SME loans and infrastructure loans.

In the Staff Working Document accompanying the Mid-Term Review, the Commission states that covered bonds have proven to be a reliable source of wholesale funding for banks, including during periods of financial market stress. The Commission hopes that tackling market inefficiencies and fragmentation to achieve a more integrated EU covered bond market could help improve funding conditions for mortgage loans and public sector loans.

The ICMA Covered Bond Investor Council (CBIC) will be engaged on this new legislative proposal, when it is published, to ensure the investor voice is heard when the legislation is agreed among the legislators.

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FCA Asset Management Market Study

On 28 June 2017, the Financial Conduct Authority (FCA) published the final findings of its Asset Management Market Study and announced the package of remedies it will take forward to address the concerns identified in its interim report into the sector.

The final report confirms the findings set out in the interim report published last year. This found that price competition is weak in a number of areas of the industry. Despite a large number of firms operating in the market, the FCA's analysis found evidence of sustained, high profits over a number of years. The FCA also found that investors are not always clear what the objectives of funds are, and fund performance is not always reported against an appropriate benchmark. Finally, the FCA found concerns about the way the investment consultant market operates.

Responses to the interim report from industry, investor representatives and others have helped the FCA develop the package of remedies. The remedies the FCA are taking forward fall in to three areas:

(i) To help provide protection for investors who are not well placed to find better value for money, the FCA proposes to:

- strengthen the duty on fund managers to act in the best interests of investors and use the Senior Managers Regime to bring individual focus and accountability to this;
- require fund managers to appoint a minimum of two independent directors to their boards;
- introduce technical changes to improve fairness around the management of share classes and the way in which fund managers profit from investors buying and selling their funds.

(ii) To drive competitive pressure on asset managers, the FCA will:

- support the disclosure of a single, all-in-fee to investors;support the consistent and standardised disclosure of costs and charges to institutional investors;
- recommend that the UK DWP remove barriers to pension scheme consolidation and pooling;
- chair a working group to focus on how to make fund objectives more useful and consult on how benchmarks are used and performance reported.

(iii) To help improve the effectiveness of intermediaries, the FCA will:

- launch a market study into investment platforms;
- seek views on rejecting the undertakings in lieu of a market investigation reference regarding the institutional advice market to the Competition and Markets Authority;
- recommend that HM Treasury considers bringing investment consultants into the FCA's regulatory perimeter.

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Green and Social Bond Markets



by Nicholas Pfaff, Valérie Guillaumin and Peter Munro

GBP 2017, new Social Bond Principles and Sustainability Bond Guidelines

Summary

Following a year of further strong green bond market growth, internationalization and growing official recognition, the Green Bond Principles (GBP) held their third Annual General Meeting (AGM) in Paris on 14 June 2017. The 2017 update of the GBP was released at that time alongside new Social Bond Principles and Sustainability Bond Guidelines.

ICMA also continues its work as an observer of the EU High Level Expert Group on Sustainable Finance, providing input into an interim report to be published in July 2017. The Global Green Finance Council recently co-founded by ICMA also started work on a focused agenda including Green Loan Principles, building on the GBP.

GBP community, market growth and official recognition

The GBP are actively supported by a broad community of members and observers. These now number almost 250 – up over 30% year-on-year. They span investors, issuers, underwriters, service providers and other stakeholders globally.

In the year since the last update, issuance in the green bond market has roughly doubled to US$80 billion and stands at over US$52 billion for the year to date (source: Climate Bonds Initiative). This year issuance volume has been led by France, followed by the US and China, the latter having become the largest source of issuance in 2016. More than 90 new issuers came to the market in 2016, increasing its diversity by geography and type of issuer and extending its maturity spectrum, including landmark inaugural sovereign issues from France and Poland.

This growth and diversification was supported by important new momentum on the buy side, including new index and active funds, the rise of green bond indices and important new service offerings such as those of the rating agencies. Overall, there is growing evidence of critical mass in the market. This growth and increasing sophistication is underpinned by the GBP, which provide the voluntary framework for the organisation of the international green bond market.

The official sector has increasingly integrated the GBP as a core reference for best practice, both in developed and developing markets. New or updated guidelines referencing the GBP were issued or announced for markets including India, Japan, ASEAN, Brazil and Mexico.

GBP AGM and Conference: record attendance

The core purpose of the GBP AGM remained to present the GBP update, the new GBP Executive Committee, the results of the working groups, and to debate topical questions with members and observers. The working groups, substantially enlarged this past year in response to demand and offers of technical expertise, reported on their output over the past year – notably on enhancing the green categories, as well as publishing new guidance for impact reporting (for water and wastewater) and reports mapping the main green bond databases and indices. The AGM also featured this year a positive vote to open the GBP governance to social and sustainability bond market participants, and facilitated the introduction of upgraded guidance in these areas.

The afternoon conference that followed the GBP AGM attracted nearly 600 participants, doubling in scale versus 2016. This confirmed its role as the landmark annual conference for the green bond market. Opened by Odile Renaud-Basso, Directrice Générale du Trésor (French Treasury), patron for the event, it featured four panels and a number of keynote speakers, including Ma Jun, Chief Economist at People's Bank of China; Philippe Zaouati, CEO of Mirova and President of the Paris Green & Sustainable Finance Initiative now branded "Finance for Tomorrow"- which generously sponsored the GBP AGM & Conference; Christian Thimann, Chair of the European Commission High Level Expert Group on Sustainable Finance and Gérard Mestrallet, Chairman of the Board of Engie and Chairman of Paris Europlace. Panel discussions addressed recent developments, the market outlook, the new social and sustainable market and external reviews.

GBP update

Changes introduced in the 2017 update of the Green Bond Principles (GBP), announced at the 3rd GBP AGM are designed to clarify and strengthen the Principles, they include:

Detail on objectives of the GBP and its role in promoting the green bond market:

- project and traceability language updated to facilitate issuance growth especially from sovereigns and corporates;
- stronger guidance on issuer communication of environmental strategy and management of material environmental and social risk factors;
- expanded and additional definitions of green categories and new impact reporting metrics .

Other developments:

- release of new Social Bond Principles in support of bonds raising funds for projects with positive social outcomes, including affordable housing, employment generation, food security and socioeconomic advancement and empowerment;
- new Sustainability Bond Guidelines published to provide guidance for bonds combining green and social projects;
- social and sustainability bond market participants become eligible to become members of the GBP and fully integrated in its governance.

An online Q&A has been made available to provide detailed guidance for participants in the green, social and sustainability bond markets.

GBP Executive Committee renewal

The GBP 2017 update was coordinated, with the support of the ICMA Secretariat, by the elected Executive Committee of the GBP, composed of a balanced and representative group of 24 key market participants, divided equally between issuers, investors and intermediaries. In line with its governance, 50% of the seats of the Executive Committee were up for renewal at the AGM. Following a prior email ballot in which 69% of GBP members participated, the 2017/2018 Executive Committee is now composed as follows:

GBP Executive Committee as of June 2017		
Investors	**Issuers**	**Underwriters**
AMUNDI AM	BANK OF CHINA	BofA MERRILL LYNCH
AXA IM	EDF	BNP PARIBAS
BLACKROCK	EUROPEAN BANK OF RECONSTRUCTION AND DEVELOPMENT	CREDIT AGRICOLE CIB
CalSTRS	EUROPEAN INVESTMENT BANK	HSBC
KFW	INTERNATIONAL FINANCE CORPORATION	JP MORGAN
MIROVA	KOMMUNALBANKEN	NATIXIS
TIAA-INVESTMENTS	NORDIC INVESTMENT BANK	RABOBANK
ZURICH ASSURANCE GROUP	WORLD BANK	SKANDINAVISKA ENSKILDA BANKEN

Note: The members in blue have been elected for a two-year term, ending at the GBP Annual Meeting to be held in 2019. Excom members in black will be put up for re-election in 2018.

Other developments

ICMA continues as an observer on the EU's High Level Expert Group on Sustainable Finance. ICMA is especially focused on providing input relating to the green bond market and the key role of voluntary best market practice as represented by the GBP. An interim report is due for release on 18 July 2017, in the context of a stakeholder event.

Co-founded by ICMA early this year, the Global Green Finance Council (GGFC) assembles mainly financial sector trade associations with the aim to coordinate and cross-fertilize green finance initiatives. Following a coordination call in April, the GGFC is currently focused on a small number of priority initiatives of which the drafting of "Green Lending Principles", drawing on the Green Bond Principles. This work has now started and involves especially the Loan Market Association, the Asia Pacific Loan Market Association, the European Banking Federation, as well as ICMA and a wide range of banks.

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International Regulatory Digest




by David Hiscock, Andy Hill, Alexander Westphal and Gabriel Callsen

G20 financial regulatory reforms

On 30 March 2017, the BCBS released a consultative document, for comment by 30 June, entitled *Global Systemically Important Banks: Revised Assessment Framework*, which presents proposed revisions to the BCBS's 2013 methodology for assessing and identifying G-SIBs. The identification methodology assesses the relative systemic importance of internationally active banks based on 12 indicators in five categories, resulting in a score that measures the systemic importance of each bank. The bank's overall score is mapped to buckets that are associated with a higher loss absorbency capital requirement. The BCBS has reviewed the framework with the intention of enhancing it and ensuring that it remains consistent with its objectives, in light of any structural changes in the global banking system that could introduce new dimensions of systemic risk not previously anticipated. Having completed its review, the BCBS is consulting on several modifications and is also seeking feedback on the introduction of a new indicator for short-term wholesale funding.

On 31 March, it was announced that the members of IOSCO had approved the *Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (EMMoU), which offers securities regulators new enforcement powers for responding to the challenges arising from recent developments in global financial markets. Both the MMOU, introduced in 2002, and the EMMoU provide a mechanism for securities regulators to share essential investigative material, such as beneficial ownership information, and securities and derivatives transaction records, including banking and brokerage records. Both documents also set out specific requirements for the exchange of information, notably ensuring that no domestic banking secrecy laws or regulations prevent the sharing of enforcement information among securities regulators. The EMMoU, however, provides for additional enforcement powers that IOSCO believes are necessary for continuing to safeguard the integrity and stability of markets, protect investors, and deter misconduct and fraud.

On 11 April, the FSB published a consultation paper (for comment by 11 May) which sets out the main elements of a *Proposed Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms*. This describes a framework that will specify processes and appropriate analytical approaches for the evaluation of the effects of reforms. The framework is being developed in close collaboration with the standard-setting bodies and other stakeholders; and this consultation paper considers the framework's scope, prioritisation of evaluations, processes for measuring benefits and costs of the reforms, how to map objectives to intended outcomes, and the evaluation approaches and tools that could be used. The analysis will be data-driven and will consider a wide range of interests; with evaluations focusing on assessing the social benefits and costs, and consider private benefits and costs, that accrue to particular market participants or end-users, where this helps assess social benefits and costs. Following this public consultation, the framework will be published before the G20 Leaders' Summit in July; and application of the framework will begin over the coming years.

Noting that the comment period allowed by the FSB in relation to this consultation was a mere 30 days, which leaves very little time for the process of gathering and agreeing views from across ICMA's broad base of members, ICMA decided that in its response it would focus on just one specific element of the consultation. This was the final consultation question, which sought comments or suggestions on which individual reforms or interacting set(s) of reforms should be initially considered for evaluation as a matter of priority. Reflective of two significant, distinct strands of its work, the two topics which ICMA highlighted as priorities for further evaluation work were: (i) corporate bond and repo market liquidity; and (ii) systemic risk as applied to asset managers.

One of the outputs following from the Spring Meetings 2017 of the World Bank Group and the IMF, in Washington on 21-23 April, is a communiqué of the 35th Meeting of the International Monetary and Financial Committee (IMFC) of the IMF Board of Governors. Within the Global Economy section of this there is a paragraph headed "Safeguarding financial stability", which says: "We will further strengthen the resilience of the financial sector to continue to support growth and development. This requires sustained efforts to address remaining crisis legacies in some advanced economies and vulnerabilities in some emerging market economies, as well as monitoring potential financial risks associated with prolonged low or negative interest rates and with systemic market liquidity shifts. We stress the importance of timely, full, and consistent implementation of the agreed financial sector reform agenda, as well as finalising remaining elements of the regulatory framework as soon as possible."

Also, within the IMF Operations section of this there is a paragraph headed "Facilitate multilateral solutions to meet global challenges". Amongst other things, this says: "We reiterate the importance of ensuring effective and consistent implementation of the Institutional View on capital flows, paying greater attention to capital flow management measures and taking a clear position based on country circumstances on whether they are warranted, while exploring the role of macroprudential policies to increase resilience to large and volatile capital flows. We support the strengthened analysis of spillovers from domestic policies to the global economy. We welcome the IMF's analysis of macrofinancial linkages in bilateral surveillance. We also welcome the IMF's collaboration with other multilateral institutions in pursuit of shared objectives. We welcome the IMF's work with international standard setters to support the global financial regulatory reform agenda and to address data gaps." Related documents and statements given are also available.

The BCBS maintains a two-year work programme, endorsed by the Group of Governors and Heads of Supervision and developed under the direction of the BCBS Chairman, which outlines the strategic priorities for the BCBS's policy, supervision and implementation activities. Details of the 2017-18 work programme were announced by the BCBS, on 25 April. The BCBS' policy-related initiatives can be grouped into (i) finalising existing policy initiatives, which includes (a) the Basel III reforms, (b) review of the regulatory treatment of sovereign exposures, (c) regulatory treatment of expected loss provisioning, (d) identification and measurement of "step-in" risk provided by banks to non-bank entities and (e) targeted adjustments and simplifications to the revised market risk and securitisation frameworks; and (ii) assessing whether additional focused policy initiatives are warranted, in the light of emerging risks and the BCBS's assessment of the impact of its post-crisis reforms. An important priority for the BCBS is to continue monitoring emerging cyclical and structural risks, changes in banks' business models and innovative transactions or regulatory arbitrage techniques which may go against the objective or spirit of the BCBS framework.

The BCBS will also continue its work to assess the impact of its post-crisis reforms, including assessing the effectiveness of the BCBS's post-crisis reforms in reducing excessive variability

"We will further strengthen the resilience of the financial sector to continue to support growth and development.

of banks' risk-weighted assets. Also, the BCBS will place a greater focus on supervision, including further improving supervisory tools and techniques by developing case studies and identifying best practices, where appropriate, in a number of key areas. And, with full, timely and consistent adoption and implementation of BCBS standards considered to be crucial, the BCBS's Regulatory Consistency Assessment Programme (RCAP) will remain a high priority. During 2017, the BCBS will complete the seven remaining RCAP assessments related to the LCR, will thereafter start to review the implementation of other standards, starting with the NSFR and Large Exposures, and will also review banks' implementation of the standard on interest rate risk in the banking book.

Also on 25 April, the BCBS issued its *Twelfth Progress Report on Adoption of the Basel Regulatory Framework*, which sets out the adoption status of Basel III standards for each BCBS member jurisdiction as of end-March 2017. The report shows that: all 27 member jurisdictions have final risk-based capital rules, LCR regulations and capital conservation buffers in force; 26 have issued final rules for the countercyclical capital buffers; 25 have issued final or draft rules for D-SIBs frameworks and all home jurisdictions to G-SIBs have related final rules in force; and 20 have issued final or draft rules for margin requirements for non-CCP cleared derivatives. Further, while some members have reported challenges in implementing the following standards for which the implementation dates have now passed, the report shows that: 21 member jurisdictions have issued final or draft rules of the revised Pillar 3 framework; and 17 have issued final or draft rules of capital requirements for CCP exposures. BCBS members are now turning to the implementation of other Basel III standards, including those on TLAC holdings, the market risk framework, the leverage ratio and the NSFR.

During IOSCO's Annual Conference (which is separately reported on below), in May, the President's Committee, comprised of all the chairs of ordinary and associate members, passed a resolution approving proposed revisions to IOSCO's Objectives and Principles of Securities Regulation (Principles) and the accompanying Methodology for Assessing Implementation of the Principles. The Principles and the Methodology have been revised to reflect the contents of IOSCO reports issued since 2011. This document sets out 38 principles of securities regulation, grouped into ten categories, which are based upon the three objectives of securities regulation: protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk.

On 25 May, the Governors of the Global Economy Meeting welcomed the publication of the FX Global Code, a single global code for the wholesale foreign exchange market, as well as the establishment of the Global Foreign Exchange Committee to maintain the Code in the future. This represents the culmination of a two-year collaborative initiative between central banks and private sector market participants from across the globe. Whilst adoption and adherence are strongly encouraged, this Code is voluntary. It covers important areas including ethics, governance, execution, information-sharing, risk management and compliance as well as confirmation and settlement. The Code does not impose legal or regulatory obligations on market participants or substitute for regulation, but rather is intended to supplement local laws, rules and regulation by identifying global good practices and processes.

On 13 June, the Board of IOSCO published an IOSCO Task Force *Report on Wholesale Market Conduct*, which identifies the tools used by market regulators to minimize misconduct risk arising from the particular characteristics of wholesale markets – such as a decentralized market structure, opacity, conflicts of interest involving market makers, size and organizational complexity of market participants, and increasing automation. Relevant tools to address this risk include tailored enforcement and remedial sanctions, such as orders to participate in market structural reforms or agreed remediation and other undertakings; surveillance and data analysis to identify suspicious trades; and the protection of whistleblowers. The report also describes the regulatory requirements for market participants in wholesale markets, which are based upon broad expectations of their market conduct, such as honesty, integrity and competence – these expectations are consistent with existing IOSCO principles, standards and other initiatives on conduct regulation, including its Principles for Financial Benchmarks. Finally, the report provides an overview of the ways in which market regulators help ensure that firms and individuals meet their obligations under the legal, regulatory and supervisory frameworks in their jurisdictions.

On 22 June, the BCBS published a Range of Practices in Implementing the Countercyclical Capital Buffer (CCyB) Policy, which examines how a range of jurisdictions have implemented their CCyB policies – which are found to differ markedly is several respects. The CCyB was introduced by the BCBS in 2010, as part of the Basel III reforms, and has the macroprudential objective of protecting the banking sector from periods of excess aggregate credit growth. The document details the various national CCyB policy frameworks and operational aspects, underlining the varying discretionary elements of jurisdictions' CCyB policy frameworks and practices. The BCBS' review highlights the importance of the implementation imperative of the Basel standards and helps to clarify implementation of domestic CCyB policies.

On 24 June, the Financial Stability Institute of the BIS launched a publication series called Executive Summaries, which are concise and accessible notes covering the main financial regulatory and supervisory standards. These constitute an additional way to disseminate the work of international financial sector standard setters.

On 29 June, the BCBS published the consultative document, *Simplified Alternative to the Standardised Approach to Market Risk Capital Requirements*, for comment by 27 September. In January 2016, the BCBS issued revised minimum capital requirements for market risk, inclusive of a standardised approach which is used by banks other than those that are large and internationally active. This new consultation sets out a simplified alternative to the sensitivities-based method (SbM), which is the primary component of the standardised approach, and proposes a reduced sensitivities-based method. Use of the proposed reduced SbM would be subject to supervisory approval and oversight, and would be available only to banks that meet certain qualitative and quantitative criteria. The BCBS is also seeking feedback on whether retaining a recalibrated version of the Basel II standardised approach to market risk would better serve the purpose of including a simplified method for market risk capital requirements.

On 3 July, the FSB published, ahead of the G20 Summit in Hamburg on 7-8 July, a letter from its Chair to G20 Leaders. The letter sets out four main points: (i) G20 reforms are building a safer, simpler, fairer financial system; (ii) some unfinished business to finalise and implement reforms merits attention; (iii) the financial system is evolving, so the FSB will continue to scan the horizon to identify, assess and address new and emerging risks to financial stability; and (iv) G20 countries now have a strategic opportunity to build on this foundation to create an open, global financial system.

Additionally, the FSB published its third Annual Report on the Implementation and Effects of the G20 Financial Regulatory Reforms and, to further enhance the analysis in future, a framework for evaluating such effects. This provides further information on these points, and reports that implementation continues to progress but is uneven across the four core areas of the G20 financial reforms. The report identifies three areas where authorities need to remain vigilant: (i) maintaining an open and integrated global financial system; (ii) market liquidity; and (iii) the effects of reforms on emerging market and developing economies. The annual report asks for G20 Leaders' support to reinforce global regulatory cooperation. Alongside this, the FSB also published its Framework for Post-Implementation Evaluation of the Effects of the G20 Financial Regulatory Reforms, developed in collaboration with the standard-setting bodies and in light of a recent public consultation. This framework will guide analyses of whether the G20 reforms are achieving their intended outcomes, and help to identify any material unintended consequences that may have to be addressed, without compromising on the objectives of the reforms.

Separately, on 3 July, the BCBS published reports assessing the implementation of the LCR in China, the US and the EU. Overall, the LCR regulations in China and the US are assessed as "compliant" (the highest of the four possible grades) with the BCBS framework; while the EU LCR regulations are found to be "largely compliant" (one notch below the highest possible grade), reflecting the fact that most but not all provisions of the BCBS standards are satisfied. The EU authorities agree with the assessment that the implementation of the LCR in the EU remains largely compliant with the BCBS Standards, noting that the main qualifying observations included in the report relate to the additional recognition of assets in the definition of HQLA, the recognition of inflows on operational deposits and the calculation of the LCR for disclosure purposes. The EU authorities highlight that these observations result from conscious, explicable choices in EU legislation.

On 4 July, the BCBS published a report for the, 7-8 July, G20 Leaders' Summit, which provides an update on the implementation of Basel III regulatory reforms since the BCBS's last progress report to G20 Leaders in August 2016. Overall, further progress has been made in implementing Basel III standards. The implementation of capital and liquidity standards has generally been timely and consistent, and banks continue to build higher and better capital and liquidity buffers. BCBS member jurisdictions continue their efforts to implement other Basel III standards, with good progress in some areas, such as margin requirements for non-CCP cleared derivatives and the NSFR. However, there are challenges in other areas, such as the standardised approach for measuring counterparty credit risk and capital requirements for exposures to CCPs.

The twelfth G20 Summit at the level of the Heads of State and Government took place in Hamburg on 7-8 July. The economic and financial crisis of 2008 was the driving force behind the work of the G20. While much has already been done directly in reaction to that impetus, among many other efforts now debated at the G20, it remains a particular endeavour to strengthen the global financial system and to improve the supervision and regulation of financial market participants, including what is known as the shadow banking system. The aim is to ensure that no financial market, financial market participant or financial product remains unsupervised. Looking further ahead, on 1 December 2017, Argentina will take over the G20 Presidency and organise the G20 Summit in 2018.

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IOSCO Annual Conference

In May 2017, ICMA joined more than 400 securities regulators, industry representatives and other financial market participants, in attending the Annual Conference of the International Organization of Securities Commissions (IOSCO), as well as the Annual Meeting of the IOSCO Affiliated Members Consultative Committee (AMCC). The Conference was hosted by the Financial Services Commission of Jamaica, and took place in Montego Bay.

At the AMCC meeting, Ashley Alder (the IOSCO Chair) and Paul Andrews (the IOSCO Secretary General) outlined the key priorities and themes of the IOSCO works-streams for the coming 12 months. The high priority cross-cutting themes are:

- structural resiliency of capital markets;
- data issues (including gaps and privacy);
- investor protection and education;
- capital market development;
- financial innovation and technology.

With respect to ICMA's priorities, the key IOSCO workstreams of particular interest are those related to asset management, CCPs, and market liquidity.

Asset management

There has been intense discussion between IOSCO and the FSB, as well as the IMF, going back to 2014, with respect to "run risk" in funds. The analysis undertaken has helped to highlight analogous risks between investors in mutual funds and bank depositors, and the maturity transformation undertaken by banks. This helped drive the suggestion that some larger funds should be viewed as G-SIFIs, and IOSCO worked with the FSB on a methodology for identifying systemically important asset managers. However, this work stopped in mid-2015 when it was agreed that there were also some clear differences between funds and banks, and that this had to be part of any consideration with respect to systemic risk. Accordingly, IOSCO and the FSB moved away from a "designation" approach to fund liquidity risk to an "operational approach". This has resulted in the FSB's publication, in early 2017, of recommendations on how funds manage potentially illiquid assets and daily redemptions. IOSCO and the FSB are also developing a matrix to look at leverage in funds and IOSCO hopes to publish a consultation report on fund liquidity risk very soon.

CCPs

This is very much a continuation of work that began ten years ago in the aftermath of the crisis, and is at the centre of IOSCO's work around structural resiliency and financial stability. CCPs are recognised as playing a very different role than they did pre-crisis, and it is an explicit regulatory objective to concentrate risk in CCPs. IOSCO has worked closely with the BIS Committee on Payments and Markets Infrastructure (CPMI) to create the Principles for Financial Markets Infrastructures (PFMI), which provide international standards for managing the risks in CCPs. The workstream on CCPs is focused on creating guidelines with respect to: resiliency (CPMI and IOSCO); resolution (CPMI and IOSCO); and recovery (FSB). The intention is to publish guidelines on these three issues later this year. However, a number of issues are still unresolved, such as the relationship between recovery and resolution, as well as the proposal for variation margin haircutting (VMGH). Another key initiative is stress testing for CCPs, both at the entity level, as well as the systemic level, looking at how multiple CCPs could be impacted by a stress event.

Market liquidity

There have been many discussions within IOSCO and with the FSB related to market liquidity, in particular with respect to sovereign bond markets and corporate bond markets. In 2016 the Committee on Regulation of Secondary Markets (C2) published a study into liquidity conditions in corporate bond markets. While this noted that liquidity was changing (such as the sell-side moving from principal to agency models and more use of trading platforms), it concluded that liquidity on the whole had not been impaired by regulatory reforms. The FSB, in its work, drew similar conclusions. IOSCO is, however, aware that market reports suggest that liquidity is declining, although this is largely based on anecdotal rather than statistical evidence. That said, it recognises that there is more recent evidence that executing block trades is becoming more difficult. IOSCO also accepts that its study (based on data from 2014-15) reflects liquidity conditions in relatively benign markets.

IOSCO therefore plans to undertake a study on how corporate bond markets would function under stressed conditions. The starting point for this is a proposal not to create econometric models, but rather to map out how the market works in the real world, and who the participants are. This is intended to support the FSB and others in designing their own models, ensuring that they are more robust, and in helping to determine the appropriate underlying assumptions for these models. This work will be undertaken by the Committee for Emerging Risks (CER), and ICMA has offered its support in the exercise.

Also on the issue of market liquidity, the CER intends to look at collateral transformation. It will aim to assess how this market has evolved over recent years, how important it is for asset managers who use the market to meet margin requirements, and whether this is creating new risks. At this stage, it is intended to be a fact-finding exercise, and is expected to overlap with other work and initiatives such as ESMA's SFTR, the FSB work on collateral, and the BIS work on repo markets. Again, ICMA has offered its active support and the expertise of its relevant members and committees.

An official IOSCO media release on the IOSCO Board and AMCC meetings was published ahead of the opening of the Public Conference.

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European financial regulatory reforms

On 19 May 2017, the European Commission and the ECB held their latest annual joint conference on financial integration in Europe. This conference focused on the latest developments of the EU financial sector, as well as Banking Union and the CMU as catalysts for further financial integration in Europe. At the conference, the European Commission presented its annual European Financial Stability and Integration Review and the ECB its annual report on Financial Integration in Europe. Keynote speeches were given by Commission Vice-President Valdis Dombrovskis, on European financial integration, and ECB Vice-President Vítor Constâncio, on synergies between Banking Union and Capital Markets Union; and in two high-level panels, key policy makers, financial market leaders and academics discussed the achievements and further steps for the Banking Union as well as the long-term vision for CMU.

The European Commission proposed an overhaul of the existing European Venture Capital Funds (EuVECA) and the European Social Entrepreneurship Funds (EuSEF) regulations in 2016 as part of the CMU Action Plan. The objective of these reforms is to improve access to finance for small and growing companies and social enterprises to promote jobs and growth. Taking forward this initiative, on 30 May, the Commission announced an agreement intended to open up EuVECA and EuSEF to fund managers of all sizes and to allow a greater range of companies to benefit from EuVECA investment. The agreement also aims to improve access of investors to small and growing businesses and social ventures; and will make the cross-border marketing of EuVECA and EuSEF funds less costly, and simplify registration processes.

Also on 30 May and in the context of the CMU Action Plan, it was announced that, following extended debates, the European Parliament, the Council and the Commission had agreed on a package that sets out criteria for STS securitisation. This new regulatory framework sets out a risk-sensitive, transparent and prudential treatment of securitisation; and, at the same time, is intended to ensure an appropriate capital treatment of securitisation instruments in general.

Following the European Commission's, 1 March, *White Paper on the Future of Europe*, on 31 May, the Commission set out possible ways forward for deepening Europe's Economic and Monetary Union (EMU). This reflection paper builds on the *Five Presidents' Report* of June 2015 and is intended both to stimulate the debate on the EMU and to help reach a shared vision of its future design. Paying due attention to the debates in Member States and to the views of other EU institutions, the paper sets out concrete steps that could be taken by the European elections in 2019, as well as a series of options for the following years, when the architecture of the EMU would be completed.

The options proposed in the reflection paper are intended to help build a broad consensus on how to take on the challenges ahead and to give a fresh impetus to this important debate. Within this reflection paper, section 4.3 (at page 19), "a Genuine Financial Union – Advancing in Parallel on Risk-Reduction and Risk Sharing", includes points relating to reducing risks; completing the Banking Union; delivering CMU; and, finally, beyond Banking Union and CMU. This final segment discusses that medium-term measures could, among others include possible further steps on the (i) development of a so-called European safe asset for the euro area; and (ii) regulatory treatment of government bonds.

New priority actions are to strengthen the powers of ESMA to promote the effectiveness of consistent supervision across the EU and beyond.

CMU Action Plan: Mid-Term Review

On 20 January, the European Commission launched a public consultation on the planned CMU Mid-Term Review. ICMA responded, on 10 March, focusing on the successful completion of those workstreams in which it is involved rather than the launch of new measures.

On 11 April, the European Commission held a Public Hearing on the CMU Mid-Term Review, with Commission Vice-President Dombrovskis giving a speech at the start of the morning. Panel discussions were then held on "CMU implementation so far and key challenges and priorities for the Mid-Term Review"; and "Promoting access to finance for SMEs". At the start of the afternoon, Commission Vice-President Katainen gave a speech, following which there were further panel discussions on "Better investment opportunities for retail and institutional investors"; and "Improving the functioning of the single market by removing barriers to cross-border flow of capital". Steven Maijoor (Chair, ESMA) then gave a closing keynote speech, ahead of closing remarks given by John Berrigan (Deputy Director-General, DG FISMA).

Then, on 8 June, the European Commission announced its adoption of the Mid-Term Review of its Capital Markets Union Action Plan, which reports on the progress made so far and identifies a number of new initiatives to revamp the key regulatory reform programme to meet new challenges. It reports that good progress has been made in implementing the 2015 Action Plan, with around two-thirds of the 33 actions delivered in 20 months; identifies significant outstanding measures that will be unveiled in the coming months, along with the timeline for these; and reinforces the initial action plan with nine new priority actions.

The nine new priority actions are to:

1. strengthen the powers of ESMA to promote the effectiveness of consistent supervision across the EU and beyond;
2. deliver a more proportionate regulatory environment for SME listing on public markets;
3. review the prudential treatment of investment firms;
4. assess the case for an EU licensing and passporting framework for FinTech activities;
5. present measures to support secondary markets for NPLs and explore legislative initiatives to strengthen the ability of secured creditors to recover value from secured loans to corporates and entrepreneurs;
6. ensure follow-up to the recommendations of the High-Level Expert Group on Sustainable Finance;
7. facilitate the cross-border distribution and supervision of UCITS and AIFs;
8. provide guidance on existing EU rules for the treatment of cross-border EU investments and an adequate framework for the amicable resolution of investment disputes; and
9. propose a comprehensive EU strategy to explore measures to support local and regional capital market development.

Alongside the CMU Mid-Term Review, the Commission is also unveiling measures to encourage long-term investment through a review of prudential calibration for investments in infrastructure corporates, proposing to reduce the amount of capital that insurance companies need to hold for these. In addition, the Commission will advance on outstanding actions under the 2015 Action Plan, in particular by putting forward legislative proposals on:

1. a pan-European personal pension product, to help people finance their retirement;
2. an EU-framework on covered bonds, to help banks finance their lending activity; and
3. securities law, to increase legal certainty on securities ownership in the cross-border context.

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As foreseen in the CMU Mid-Term Review, on 29 June, the European Commission launched its proposal to provide pension providers with the tools to offer a simple and innovative pan-European personal pension product (PEPP). This new type of voluntary personal pension is designed to give savers more choice when they are putting money aside for old age and provide them with more competitive products. PEPPs will have the same standard features wherever they are sold in the EU and can be offered by a broad range of providers, such as insurance companies, banks, occupational pension funds, investment firms and asset managers. They will complement existing state-based, occupational and national personal pensions, but not replace or harmonise national personal pension regimes. The Commission is also recommending that Member States grant the same tax treatment to this product as to similar existing national products.

Ahead of the, 1 July, commencement of the Estonian Presidency of the Council of the EU, on 29 June, the Estonian Government approved the programme of the Estonian Presidency, outlining the issues and values that Estonia wishes to focus on over the next six months. The programme of the Estonian Presidency is composed of four priority areas: (i) an open and innovative European economy; (ii) a safe and secure Europe; (iii) a digital Europe and the free movement of data; and (iv) an inclusive and sustainable Europe. Within the programme, the first of these areas includes those points which most directly relate to the ongoing process of financial regulatory reform.

On page 7 of the programme, it says: "The Estonian Presidency aims to create optimal conditions for sustainable economic growth and a shock-resistant euro area. While the European Economic and Monetary Union has been strengthened in recent years, a number of projects are still ongoing. A stable and resilient banking sector will help to prevent economic and financial crises; the further reduction of risks is a necessary step towards completing the banking union. Estonia wants to further develop the proposals on establishing common rules in order to reduce risk and strengthen confidence in the banking sector. This will bolster financial stability and confidence in the euro and reduce pressure on using taxpayers' money to support the sector."

And, going onto page 8, it continues: "A functioning Banking Union and Capital Markets Union will facilitate the distribution of risks between the private and public sector in the European Union and contribute to the funding of companies and financial stability. The European Commission has prepared a mid-term review of the development of the Capital Markets Union, for which Estonia plans to set out new goals in close cooperation with the Member States in Council Conclusions. In building on the Commission's Capital Markets Union Mid-Term Review, we will set out next steps for strengthening capital markets and removing restrictions on the free movement of capital."

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Financial benchmarks

On 28 April 2017, the Bank of England revealed that the Working Group on Sterling Risk-Free Reference Rates – a group of major dealers active in sterling interest rate swap markets – had announced the Sterling Overnight Index Average (SONIA) as its preferred near risk-free interest rate (RFR) benchmark for use in sterling derivatives and relevant financial contracts. This expression of market support for SONIA is expected to act as a platform for further work to broaden and promote its use as an alternative to sterling LIBOR, contributing to an improvement in the resilience of the financial system.

The working group voted on its preferred RFR, choosing between three candidates: SONIA, Sterling Secured Overnight Executed Transactions (£SONET), and Sterling Repo Index Rate (£RIR) – all three of which are based on robust transaction volumes and measure overnight interest rates that are considered close to risk-free. The decision in favour of SONIA was by more than the required two-thirds supermajority. This recommendation is subject to a broad market consultation, launched on 29 June for comment by 29 September.

On a related theme, in the US, on 22 June, the Alternative Reference Rates Committee (ARRC) identified a broad Treasuries repo financing rate, which the Federal Reserve Bank of New York has proposed publishing in cooperation with the Office of Financial Research, as the rate that, in its consensus view, represents best practice for use in certain new US dollar derivatives and other financial contracts. The ARRC considered the input of a wide range of market participants in making its recommendation, holding a public roundtable and consultation to discuss its interim report and seeking the views of an Advisory Group of end users. The ARRC plans to publish its final report later this year, before implementation is expected to begin.

On 4 May, the European Money Markets Institute (EMMI) announced that it had concluded data analysis conducted in the context of the EURIBOR Pre-Live Verification Program. EMMI's analysis has concluded that, under the current market conditions, it will not be feasible to evolve the current EURIBOR methodology to a fully transaction-based methodology following a seamless transition path. These findings have been corroborated by analyses carried out by the Belgian Financial Services and Markets Authority (FSMA); and the FSMA, jointly with ESMA, issued a related statement. Accordingly, over the coming months EMMI will now instead focus on developing a hybrid methodology, capable of adapting to the prevailing market conditions. In the meantime, EURIBOR will be continued as a quote-based benchmark.

The EU Benchmarks Regulation, of 8 June 2016, on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, entered into force on 30 June 2016; and, save for some technical provisions which already apply, is set to apply as from 1 January 2018. The Regulation empowers the European Commission to adopt delegated and implementing acts to specify how competent authorities and market participants shall comply with the obligations of the Regulation; and assigns certain related tasks to ESMA.

On 2 June, ESMA published a methodological framework developed to promote convergence in relation to the supervision of critical benchmarks. It is addressed to NCAs in jurisdictions where such benchmarks are based. ESMA has developed the framework to assist NCAs in their selection of supervised entities to be compelled to contribute input data to critical benchmarks should its representativeness become at risk at some point in the future. It applies to all Interbank Offered Rates and to the Euro Overnight Index Average (EONIA®). Selection of the supervised entities shall be made based on the size of a supervised entity's actual and potential participation in the market that the benchmark intends to measure. The publication of the framework does not imply any immediate need to use compulsory powers.

Alongside this, ESMA has also published draft RTS on the minimum contents for cooperation arrangements between ESMA and NCAs in third countries that have been designated as equivalent under the EU Benchmarks Regulation. These RTS will enhance negotiation of the relevant arrangements and thereby allow for the use of third country benchmarks soon after an equivalence decision has been adopted. They will also ensure convergence on cooperation arrangements entered into by EU NCAs and third country NCAs when they supervise administrators that apply for recognition in the EU.

On 30 March, ESMA published its final report in respect of the draft technical standards required under the EU Benchmarks Regulation, ready for consideration by the European Commission. Subsequently, on 22 June, the European Commission published its associated draft texts, for comment by 20 July, in respect of four Delegated Regulations. These are the draft Regulations:

- specifying technical elements of the definitions laid down in paragraph 1 of Article 3 of the Benchmarks Regulation;
- for the calculation of total values of references to benchmarks;
- specifying the application of qualitative criteria for critical benchmarks; and
- on conditions to assess impacts of cessation or changing of a benchmark.

Commission Implementing Regulation (EU) 2017/1147, of 28 June 2017, was published in the *Official Journal*. This amends Implementing Regulation (EU) 2016/1368 establishing a list of critical benchmarks used in financial markets pursuant to the EU Benchmarks Regulation. This makes the Euro Overnight Index Average (EONIA®) a critical benchmark, alongside the Euro Interbank Offered Rate (EURIBOR®), which was listed in the earlier Implementing Regulation. Both these critical benchmarks are administered by EMMI.

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Credit rating agencies

ESMA issued clarification on credit ratings and rating outlooks publication timelines, by publishing an update, dated 30 March 2017, to its Q&A on implementation of the Regulation (EU) No 462/2013 on credit rating agencies (CRAs). The updated information is presented as question 11, which asks: (a) When should a CRA notify a rated entity about the publication of a credit rating or rating outlook to which the rated entity is subject?; and (b) How much time is required to elapse before a CRA can publish a credit rating or rating outlook after it has been notified to the rated entity?

On 4 April, ESMA published a consultation paper, for comment by 3 July, on updating its Guidelines on the application of the endorsement regime under the EU CRA Regulation. Endorsement is a regime under the CRA Regulation, which allows credit ratings issued by a third-country CRA, and endorsed by an EU CRA, to be used for regulatory purposes in the EU (a credit rating that has been endorsed is considered to have been issued by the endorsing EU CRA). The endorsement regime is available for CRAs of systemic importance with global networks of affiliates. The consultation paper sets out a number of changes and clarifications to the existing Guidelines focusing, in particular, on the obligations of the endorsing CRA and ESMA's supervisory powers over endorsed credit ratings. The revised Guidelines are expected to be published in 4Q 2017.

On 6 April, ESMA published a supervisory briefing on *A Common Approach to the CRA Regulation's Provisions for Encouraging the use of Smaller CRAs*. The purpose of this supervisory briefing is to provide guidance to Sectoral Competent Authorities in relation to the application of Articles 8c and 8d of the EU CRA Regulation and promote a common supervisory approach and enforcement of these Articles. In this regard, the supervisory briefing includes the following: (i) a common supervisory approach as to which issuers and related third parties are covered by Article 8c and 8d; and (ii) a standard form for documentation in accordance with article 8d.

On 3 May, the Head of ESMA's Investors and Issuers Department spoke at a hearing of the European Parliament's ECON Committee. This scrutiny session concerned Level 2 measures and reports under the EU CRA Regulation. ESMA shared some of the experience and insights it has gained through its work on these important and challenging items. To do so, ESMA first provided some context on the CRA Regulation and ESMA's Level 2 work. It then talked through the technical standards and advice provided under CRA III. And, finally, ESMA discussed where it is focusing its CRA policy work in the near future.

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These reforms are intended to provide simpler and more proportionate rules for OTC derivatives, and to reduce costs and regulatory burdens for market participants.

OTC (derivatives) regulatory developments

On 5 April 2017, ESMA issued an opinion on the European Commission's proposal for the EU Regulation on CCP Recovery and Resolution. The proposal gives NCAs supervision and early intervention powers in relation to CCP recovery. For CCP resolution, the proposal asks Member States to designate National Resolution Authorities to develop CCP resolution plans. In both cases, ESMA will have a mediator role to ensure consistency. ESMA, in its opinion, expresses its views on arrangements for CCP recovery and resolution and, in particular, the impact of the proposal on ESMA as an organisation, including for its resources.

On 10 April, ESMA issued an opinion regarding the implementation of portfolio margining requirements for CCPs under EMIR. EMIR provides that CCPs can offset or reduce the required margin across instruments which they clear, if the price risk of one of the instrument is significantly and reliably correlated to the price risk of other financial instruments; and, in those cases, CCPs may apply portfolio margining. ESMA's opinion clarifies as to when two contracts can or cannot be considered as the same instrument for the purpose of portfolio-margining, and that CCPs have to limit the reduction in margin requirement when portfolio-margining different instruments.

On 18 April, ESMA announced that it had established an MoU, effective as of 28 February 2017, under EMIR with the Reserve Bank of New Zealand and the Financial Markets Authority of New Zealand. This establishes cooperation arrangements, including the exchange of information, regarding CCPs which are established and authorised or recognised in New Zealand, and which have applied for EU recognition under EMIR.

On 4 May, the European Commission proposed some targeted reforms to improve the functioning of the derivatives market in the EU. These reforms are intended to provide simpler and more proportionate rules for OTC derivatives, and to reduce costs and regulatory burdens for market participants without compromising financial stability. These reforms to EMIR build on the results of the Commission's Call for Evidence, a public consultation looking at the cumulative effect of the new financial sector rules put in place since the crisis.

The proposal introduces more proportionate rules for corporates; re-focuses the scope of the clearing obligation for financial counterparties to include some additional relevant market players while exempting the smallest financial counterparties; and also allows for more time to develop clearing solutions for pension funds. In addition, it streamlines the application of reporting requirements and making them more proportionate; and introduces improvements to better ensure the quality of reported data.

Alongside this, the Commission also adopted a Communication setting out its intentions to present further legislative proposals before the summer to address important and emerging challenges in derivatives clearing, as its scale and importance grows. Further changes to EMIR are considered to be necessary to ensure financial stability, as well as the safety and soundness of CCPs that are of systemic relevance for EU markets and to support the further development and deepening of the CMU. In particular, the future proposal should seek to enhance the common EU supervisory arrangements for CCPs.

Subsequently, on 13 June, the European Commission put forward its proposal for more robust supervision of CCP activities in the EU, based on an assessment of the existing supervisory arrangements for CCPs as well as on feedback from a series of public consultations. The proposal introduces a more pan-European approach to the supervision of EU CCPs, to ensure further supervisory convergence and accelerate certain procedures; and also aims to ensure closer cooperation between supervisory authorities and central banks responsible for EU currencies. To achieve this, a newly-created supervisory mechanism will

Conducting stress tests of this type could help authorities better understand the impact on the broader economy of a common stress event affecting multiple CCPs, as well as the implications of interdependencies between markets, CCPs, and other entities.

be established within ESMA (a Board of Supervisors in Executive Session – "CCP Executive Session"), which will be responsible for ensuring a more coherent and consistent supervision of EU CCPs as well as for more robust supervision of CCPs in non-EU ("third") countries.

For non-EU CCPs, the proposal builds on the existing third-country provisions in EMIR and will make the process to recognise and supervise third-country CCPs more rigorous for those which are of key systemic importance for the EU. The aim is to address important challenges in derivatives clearing as its scale and importance grows and to take account of the role played by third-country CCPs in the clearing of financial instruments relevant to EU financial stability.

The proposal introduces a new "two tier" system for classifying third-country CCPs. Non-systemically important CCPs will continue to be able to operate under the existing EMIR equivalence framework. However, systemically important CCPs ("Tier 2 CCPs") will be subject to stricter requirements, including:

- compliance with the necessary prudential requirements for EU-CCPs while taking into account third-country rules;
- confirmation from the relevant EU central banks that the CCP complies with any additional requirements set by those central banks (eg the availability or type of collateral held in a CCP, segregation requirements, liquidity arrangements, etc); and
- the agreement of a CCP to provide ESMA with all relevant information and to enable on-site inspections, as well as the necessary safeguards confirming that such arrangements are valid in the third country.

Depending on the significance of the third-country CCP's activities for the EU and Member States' financial stability, a limited number of CCPs may be of such systemic importance that the requirements are deemed insufficient to mitigate the potential risks. In such instances, the Commission, upon request by ESMA and in agreement with the relevant central bank, can decide that a CCP will only be able to provide services in the EU if it establishes itself in the EU.

On 31 May, ESMA announced that it had registered Bloomberg Trade Repository Limited as a TR under the EMIR, with effect from 7 June 2017. Bloomberg Trade Repository Limited is based in the UK and covers the following derivative asset classes: commodities, credit, FX, equities and interest rates. This registration brings the total number of TRs registered in the EU to seven, which can be used for trade reporting.

On 1 June, ESMA opened a public consultation, for comment by 24 August, on future guidelines, which further clarify provisions stemming from the EMIR. Feedback is sought on a set of proposed provisions regarding the management and avoidance of conflicts of interests by CCPs. EMIR requires CCPs to act in the best interests of their clearing members and the clients, so CCPs need to put in place robust organisational arrangements and policies to prevent potential conflicts of interest and to solve them should they occur. Conflicts of interest exist when a stakeholder's own interests interfere with the CCP's interests or the CCP's clearing members' or clients' interests.

On 19 June, ESMA published a consultation paper, for comment by 31 July, regarding its draft technical standards specifying the trading obligation for derivatives under MiFIR. MiFIR's trading obligation will move OTC trading in liquid derivatives onto organised venues. ESMA invites stakeholders to provide feedback on its approach, which was revised following an earlier consultation in 2016. ESMA will use the feedback to finalise this draft RTS, which will then be sent to the European Commission for endorsement.

On 28 June, draft guidance for authorities on how to design and run supervisory stress tests for CCPs was released by the CPMI and IOSCO. The consultative report, for comment by 22 September, provides a framework for authorities to evaluate the collective response of a set of CCPs to one or more financial stresses. In particular, conducting stress tests of this type could help authorities better understand the impact on the broader economy of a common stress event affecting multiple CCPs as well as the implications of interdependencies between markets, CCPs and other entities, such as liquidity providers and custodians. The framework covers six components of a stress-testing exercise, which are intentionally broad and flexible to allow authorities to develop the most suitable approach for their circumstances. Authorities are encouraged, but not required, to use the framework as they deem appropriate.

On 29 June, the FSB published three reports setting out progress on reforms to OTC derivatives markets. The FSB's *Review of OTC Derivatives Market Reforms: Effectiveness and Broader Effects of the Reforms*, provides a comprehensive review of the reforms and their effects; *OTC Derivatives Market Reforms: Twelfth Progress Report on Implementation*, provides a detailed update on progress since 2016 in implementation of the reforms across FSB member jurisdictions; and the *Progress Report on FSB Members' Plans to Address Legal Barriers to Reporting and Accessing OTC Derivatives Trade Data*, reports on progress since these plans were published in August 2016. The FSB, working with standard-setting bodies, will use its new post-implementation evaluation framework (published ahead of the Hamburg, July 2017, G20 Summit) to assess the interaction of the reforms on incentives to centrally clear OTC derivatives and will publish the results from this work in late-2018.

ESMA's list of CCPs authorised to offer services and activities in the EU, in accordance with EMIR, was last updated on 30 June; and its list of third-country CCPs recognised to offer services and activities in the EU was last updated on 8 June. ESMA's *Public Register for the Clearing Obligation* under EMIR was last updated on 30 June; whilst its (non-exhaustive) list of CCPs established in non-EEA countries which have applied for recognition was last updated on 18 April.

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Market infrastructure

ECB: Advisory Groups on market infrastructure

As previously reported, the ECB recently reformed its infrastructure related contact groups. Two new groups were created as a result: the Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo) and the AMI-Pay which focuses on questions related to payments. Both groups directly feed into the ECB's Market Infrastructure Board (MIB) and thus help to steer the Eurosystem's initiatives in the field of market infrastructure which are covered more in detail in a separate section below.

The **AMI-SeCo**, which combines the tasks and responsibilities of the old COGESI and T2S Advisory Group, met for the first time in March. A summary of the meeting as well as all the relevant documents have been published on the ECB website. Following the first meeting, a more focused workshop was held on 11 May in Madrid. The purpose of the workshop was to specifically discuss the ECB's collateral framework and in particular the proposal to restrict the mobilisation of marketable collateral for Eurosystem credit operations to the T2S environment. The workshop itself was followed by a short written consultation among AMI-SeCo members to which the ERCC Operations Group, which is represented in the AMI-SeCo through its Co-Chair Nicholas Hamilton, submitted a short response. The next regular two-day meeting of the AMI-SeCo was held on 4-5 July in Frankfurt.

The **AMI-Pay** has already met twice since its creation. The inaugural meeting of the group was held on 9 February 2017 and a second meeting took place on 3 May. Important topics discussed included TARGET2 operations as well as the initiatives launched by the ECB in relation to instant payments and the consolidation of T2 and T2S services (see below). Summaries of both meetings as well as the relevant meeting documents and presentations are available on the ECB website. In addition to the two regular meetings, AMI-Pay members also participated in a conference call on 21 March which focused on a market consultation launched by the ECB in relation to TARGET Instant Payment Settlement (TIPS) service.

ECB: Other market contact groups

Members of the **Bond Market Contact Group** (BMCG) had their latest quarterly meeting on 16 May in Frankfurt. Besides the general bond market developments and outlook, the meeting included an exchange of views on the implications of Brexit, introduced by Morgan Stanley, a discussion on FinTech and electronification in bond markets, based on a joint presentation by Tradeweb and Citi, and a reflection on secondary market liquidity and the impact of repo liquidity in this context. The latter agenda item was introduced by a presentation jointly prepared by ICMA CEO Martin Scheck, who represents the Association in the Group, and Laurent Clamagirand of AXA. A summary of the meeting is available on the BMCG webpage. The next regular BMCG meeting will be held on 10 October 2017.

The **Money Market Contact Group** (MMCG) had its latest regular meeting on 13 June in Milan. The group reviewed recent developments and conditions in the euro money markets and FX swap markets more specifically and also covered other important topics including intra-day liquidity management, based on four case studies presented by MMCG members, as well as euro money market benchmarks, introduced by a presentation from Barclays. A summary of the meeting and the related presentations are available on the MMCG webpage. The next quarterly MMCG meeting will be held on 26 September in Frankfurt.

In addition to the formal contact groups, the ECB holds regular meetings with institutional investors within its **Institutional Investor Dialogue** (IID). The IID is chaired by the ECB President and serves as a forum of interaction at the highest level between the ECB and non-bank financial institutions to discuss industry developments and structural trends of particular importance for the euro area financial markets. The meetings generally take place semi-annually, and the latest meeting was held on 5 April 2017 with 12 major buy sides in attendance. At this meeting, participants discussed the outcome of a recent investor survey, exchanged views on general global investment trends and focused on recent trends and the outlook for the ETF market. Agendas and summaries of the meetings are available on the IID webpage.

Eurosystem: Vision on the future of financial market infrastructure

The Eurosystem is evolving its vision on the future of financial market infrastructure in Europe. The Eurosystem's strategy in this context centres around three key building blocks which Yves Mersch, Member of the ECB's Executive Board, set out in a speech in September 2016:

- a consolidation of TARGET2 and TARGET2-Securities (T2S);
- settlement services to support instant payments;
- a potential Eurosystem collateral management system (ECMS).

The work on all three components continues to progress, with the initiative on instant payments being the most advanced. Following a market consultation earlier this year, a dedicated Task Force prepared detailed user requirements for the so-called TARGET Instant Payment Settlement (TIPS) service, which aims to enable payment service providers to develop electronic real-time payment solutions for retail clients that are available around the clock, 365 days a year. On 22 June, the final TIPS proposal was approved by the ECB's Governing Council and will be implemented over the next year. The TIPS service will be developed in close cooperation with the banking industry in Europe and is scheduled to start operating in November 2018.

Work is also already well advanced on the consolidation of the TARGET2 and T2S services. On 10 May, as part of this initiative the ECB launched a second market consultation on the future services provided in the context of its Real-Time Gross Settlement (RTGS) System. There are three key components to this consultation: (i) a Central Liquidity Management service; (ii) future RTGS services; and (iii) shared services. Detailed draft user requirements have been published for all three components alongside a summary of the proposals and a glossary of terms. Market participants had time until 30 June to submit comments on the final proposals.

Although the least advanced among the three initiatives listed above, work is also progressing on the third component, the project to create a harmonised Eurosystem Collateral Management System (ECMS) which would aim to replace the current collateral framework based on the still rather fragmented Correspondent Central Banking Model (CCBM). A dedicated internal Task Force has been set up by the ECB to prepare a more detailed proposal on this issue and the project is also discussed with market participants represented in the AMI-SeCo.

The ECB is holding another Focus Session to inform market participants of the latest developments in the field of market infrastructure. The session was held on 7 July 2017 in Frankfurt and focused primarily on the Eurosystem's TIPS initiative.

ECB: TARGET2-Securities (T2S)

With the successful conclusion of T2S migration wave 4 in February 2017, the volume of securities transactions settled on the T2S platform has now reached around 90% of the total expected volume. Around half a million transactions now settle on the T2S platform every day. The fifth and final migration wave is still ahead, scheduled for 18 September 2017. Preparations for this final migration, which will see the onboarding of CSDs from Spain and the Baltics, are well under way and on track for the scheduled date with the final pre-migration phase launched on 20 June.

On 19 April, the ECB published the T2S Annual Report 2016 which contains a more detailed account of all the relevant T2S developments and milestones achieved over the past year, some interesting statistics on T2S operations and settlement efficiency as well as an outlook into the future once the T2S migration has been concluded.

European Commission: European Post-Trade Forum (EPTF)

The EPTF is an Expert Group established by the European Commission in early 2016 in the context of the CMU project. The group was tasked to undertake a detailed review of all remaining barriers to cross-border clearing and settlement in Europe. This task has now been concluded. The EPTF met on 24 April for a last session in Brussels to finalise its detailed report. The final EPTF report sets out 12 barriers to an integrated post-trade environment in Europe and recommends concrete actions to resolve these. Some of the problems highlighted in the report had been previously identified, most importantly in the two Giovannini reports of the early 2000s, while others have arisen more recently mainly as a result of market and legislative changes. Barriers covered in the report are split into four categories: operational issues (eg messaging standards, corporate actions), structural barriers (eg asset segregation, post-trade reporting), important legal inconsistencies and uncertainties, as well as inefficiencies in tax collection procedures. In addition to the 12 EPTF barriers, the report also highlights five additional issues that should be closely monitored as they are considered as potential barriers that might materialize in the future. This category includes remaining national restrictions on the activity of primary dealers and market makers, intraday liquidity management, and insufficient collateral mobility. The ERCC has been part of the EPTF, represented through its Chairman, Godfried De Vidts, and has contributed to the report with a particular focus on repo and collateral.

The final EPTF report, including a detailed annex with a description of the current post-trade landscape, should be published by the European Commission in the course of the next months, along with a wider market consultation on the issues covered in the report.

ESMA: Post-trading

On 10 March 2017, the Level 2 measures related to the EU CSD Regulation, with the exception of the technical standards on settlement discipline, were published in the *Official Journal*. ESMA continues to work, however, on the so-called Level 3 measures, which include guidelines and Q&As. The latest set of CSDR guidelines was published by ESMA on 1 June, specifying (i) the most relevant currencies in which settlement takes place; and (ii) the substantial importance of a CSD for a host Member State. ESMA also continues to update its CSDR Q&As, most recently on 2 June, adding three more questions to the list. A useful overview of all the measures adopted under the CSDR is available on ESMA's website.

On 21 June, ESMA published a call for applications to renew the composition of the Consultative Working Group (CWG) of the ESMA Post-Trading Standing Committee (PTSC). ESMA is looking for a diverse group of market stakeholders to be represented in the CWG which is expected to support ESMA developing a policy line on specific technical matters or proposals related to relevant EU post-trade legislation, including EMIR, CSDR and SFTR. Members of the CWG are selected for a renewable term of two years. The deadline for interested market experts to apply is 31 July.

Global Legal Entity Identifier System (GLEIS)

With the implementation date of MiFID II/R in January 2018 approaching rapidly, concerns in the market are growing that the slow adoption of LEIs could create serious issues if no solution is found in the next months. As previously reported, firms subject to MiFIR transaction reporting obligations will not be able to execute a trade on behalf of a client who is eligible for an LEI and does not have one. Importantly this requirement also applies to many non-EU entities, who are otherwise not obliged to obtain an LEI and are often not aware of this requirement. Communication with all relevant clients is thus key to avoid any disruption. ISDA and GFMA have jointly issued an alert to help raise awareness of the issue. In addition, to further facilitate compliance, the Global LEI Foundation (GLEIF), the operating arm of the GLEIS, has created the concept of "registration agents", to allow third parties to assist other legal entities, including clients, to obtain an LEI from one of the Local Operating Units (LOUs), responsible for the actual issuance of LEIs.

While the mandatory use of LEIs in Europe is thus imminent, regulators in other jurisdictions are also starting to put in place LEI related requirements albeit at a much lower pace. The GLEIF is monitoring such regulatory developments around the world and has produced a useful overview that is regularly updated.

The total number of LEIs issued by LOUs around the globe is steadily growing also due to regulatory pressures and has reached 525,000 by July 2017. The propagation of LEIs differs though considerably across jurisdictions, as is illustrated by the detailed LEI statistics which are published by the GLEIF. While the coverage is already significant in Europe and the US, take-up in other parts of the world is often still very limited. The GLEIF website also contains a free LEI search tool which gives access to the full database of LEIs.

There is a more detailed overview of all the recent developments in relation to LEIs in the GLEIF's recently published Annual Report 2016, as well as a May 2017 update published by GLEIF CEO Stephan Wolf on the GLEIF blog, which presents a collection of recent news related to LEIs from across the world.

BIS: Committee on Payments and Market Infrastructures (CPMI)

CPMI and IOSCO continue to evolve their joint work in relation to globally harmonised data for OTC derivatives reporting. This includes proposals on unique identifiers, in particular the Unique Transaction Identifier (UTI) and the Unique Product Identifier (UPI), but also various other data elements. While primarily targeted at derivatives reporting, it is important to keep in mind that many of the data elements, in particular UTIs, will also be relevant for other markets, eg SFTs. The latest consultation in this context was published by CPMI-IOSCO on 27 June 2017 and sets out proposals on a third batch of critical data elements (other than UTI and UPI). The consultative report follows up on previous consultations on the first two batches of data elements as well as the separate reports related to UTIs and UPIs.

CPMI and IOSCO also continue to jointly monitor progress in the implementation

The final EPTF report sets out 12 barriers to an integrated post-trade environment in Europe and recommends concrete actions to resolve these.

of the 2012 *Principles for Financial Market Infrastructures* (PFMI) across all 28 CPMI jurisdictions around the world. The assessments undertaken in this context are divided into three levels: (i) Level 1 reports which are based on self-assessments by individual jurisdictions on how they have implemented the different Principles set out in the PFMI, (ii) Level 2 reports that analyse the completeness of jurisdictions' implementation measures and their consistency with PFMI; and (iii) Level 3 reports which look at the consistency in the outcomes of such frameworks. An initial Level 1 assessment report was published in August 2013 covering all 28 jurisdictions and has been regularly updated since then. Work is also ongoing at Levels 2 and 3. On 24 May 2017, CPMI-IOSCO published the latest Level 2 assessment report in relation to Hong Kong SAR. Similar Level 2 reports had previously been published for the EU, Japan, US and Australia.

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Market electronification and FinTech

FinTech, a term broadly used to describe innovation in financial services enabled by technology, and market electronification are areas ICMA has been closely monitoring and discussing with members. The technical issues ICMA is addressing internally and by exchanging information with members cover (i) primary markets, (ii) secondary markets, (iii) post-trade processing, and (iv) RegTech.

Primary markets electronification

While there has been a notable shift towards greater electronification (and automation) in secondary markets and also in post-trade processing, primary markets have to date been less impacted by technology.

ICMA's focus on FinTech solutions in primary markets is on the currently prevailing, syndicated bookbuilding method of executing benchmark size, corporate bond issuance. This method comprises a set of individual processes which remain mostly manual and fragmented, ranging from roadshows, orderbook management, and deal completion to transaction settlement. While a number of solutions have emerged that automate processes at different stages of the issuance process, there is currently no established, single solution spanning the entire lifecycle.

ICMA engages with members on this topic through the Primary Market Practices Committee (PMPC), which gathers the heads and senior members of the syndicate desks of ICMA member banks active in lead-managing syndicated bond issues in Europe. In addition, ICMA staff have also been involved in bilateral discussions with providers of electronic solutions that feed into discussions in the PMPC. To shed light on the landscape of existing and emerging FinTech solutions in primary markets, ICMA will continue to engage with members and providers.

Secondary markets electronification

While "electronification" in fixed income markets is not a new phenomenon, most innovation has been based on creating efficiencies related to the longstanding market structure which revolves around market makers as the main source of liquidity[55]. However, as market structure is now changing due to pressure on the market-making model and the desire for the buy side to have more control over trading, we are seeing the rise of new e-solutions, focused more on "All-to-All" protocols, and "matching", rather than execution (ie axe-driven protocols, rather than quote-driven). The buy side is migrating from a traditionally passive to a more proactive role.

In light of the shift towards electronification, ICMA conducted a mapping exercise of electronic trading platforms (ETPs) and information networks. This initiative resulted in the ETP Mapping Directory, a single source of information on currently over 30 infrastructure providers, which is updated on a regular basis and covers

55. ie 95% of electronic fixed income trading is based on the request-for-quote model (BIS, 2016)

all cash bond classes. Following the publication of the directory, buy-side members of the ICMA Electronic Trading Working Group invited trading venues to present their platforms through interviews and questionnaires.

ICMA has further addressed electronification both under the ICMA Secondary Market Practices Committee (SMPC) and in dedicated working groups.

- The *Electronic Trading Working Group (ETWG),* which comprises buy-side and sell-side heads of fixed income trading or market structure. This group discusses market structure, platform and protocol, execution, regulation and practical implementation strategy.
- The *Platform Working Group (PWG),* which brings together non-market makers ie brokers and broker-owned Multilateral Trading Facilities (MTFs), exchange-owned MTFs and future Organised Trading Facilities (OTFs) (eg interdealer brokers). Discussions focus on the practical implementation of MiFID II for cash bonds and other regulations, as well as interaction with ETWG members, particularly on the buy side.

The papers, *The Future of Electronic Trading in European Cash Bonds* and *Bond Trading Market Structure and the Buy Side*, authored by Elizabeth Callaghan and published in 2016 and 2017 respectively, provide an in-depth analysis of changes in bond market trading, technological progress and electronification.

Looking ahead, ICMA will be further focusing on electronic solutions as part of the implementation of MiFID II/R. With respect to trade reporting obligations, ICMA will be carrying out further interviews with registered Approved Publication Arrangements (APAs), a reporting solution for publishing executed trades.[56] Workshops will be held to discuss the practical implementation of best execution requirements, and the role of data management solutions and transaction cost analysis (TCA). In addition, ICMA is looking to engage the platforms more with the buy side and sell side to help shape the future electronic trading market structure landscape.

Electronification of post-trade processes

Technology has an important role to play when it comes to alleviating existing frictions in the banks' back offices and contributing to a more efficient post-trade lifecycle. Members of the Operations Group (Ops) of the ICMA European Repo and Collateral Council therefore decided in 2016 to set up a dedicated FinTech Working Group (FinTech WG).

The aim is to develop a better understanding of existing tools and emerging FinTech solutions in the area of post-trade, including through greater interaction with the relevant providers. As a first step, FinTech WG members have been conducting a mapping exercise of existing FinTech solutions in the market, ranging from collateral management, matching and confirmation, to reconciliation and regulatory reporting.

While the FinTech WG has focused on existing FinTech solutions, ICMA has been monitoring market developments in the FinTech space more broadly, in particular emerging FinTech solutions such as distributed ledger technology (DLT), cloud computing and big data, which have the potential to impact market practice and introduce further electronification.

A dedicated section on the ICMA website provides an overview of key contributions on DLT, focusing on early regulatory initiatives but also referencing some of the most important industry initiatives and selected other research on DLT.

RegTech

In light of regulatory requirements, electronification and the increasing importance of collecting and processing large volumes of data, ICMA plans to focus further on developments in regulatory technology or "RegTech"[57]. Potential RegTech solutions are emerging both in primary markets (eg record-keeping for evidential purposes) and secondary markets (eg trade reporting via APAs under MiFID II / MiFIR transparency obligations), as well as collateral post-trade processing (eg reconciliation and reporting).

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56. Defined in MiFID II, Article 4 (1) (52), as "a person authorised under this Directive to provide the service of publishing trade reports on behalf of investment firms [...]".

57. Defined by the FCA as "a sub-set of FinTech that focuses on technologies that may facilitate the delivery of regulatory requirements more efficiently and effectively than existing capabilities."

FinTech: Government bonds in Kenya

Introduction: FinTech[58] has a widespread potential to enhance efficiencies, reduce costs, and facilitate access to financial services. As an interesting case study, Kenya has recently launched a Government bond leveraging mobile phone technology to promote financial inclusion.

M-Akiba Government Bond *at a glance*

Issuer:	Republic of Kenya
Size:	KES 150 million [€1.25 million]
Coupon:	10% (semi-annual)
Min. Amount:	KES 3000 [€25]
Value date:	6 April 2017
Maturity date:	6 April 2020
Listed on:	Nairobi Securities Exchange (NSE)

Following a period of testing since 2015 and initial complications linked to interest rate volatility, the launch of the bond was completed successfully in April 2017. The equivalent of €1.25 million (KES 150 million) was raised by issuing a three-year "mobile" bond, enabling investors to purchase Government debt exclusively via mobile phones. The so-called "M-Akiba" bond, which has a 10% semi-annual coupon, was aimed at retail investors and could be purchased in sizes from €25 and up to a daily maximum of €1200 per investor (approximate equivalent values).

Since Kenya has a high level of mobile phone coverage, estimated at 88%[59], the bond is considered by the Government as a means to promote financial inclusion, incentivise higher savings, and diversify investment opportunities for retail investors. The proceeds of the bond are used for infrastructure investments.

Primary market: During a two-week window starting from 23 March 2017, retail investors were able to place orders for the bond on their mobile phone which was issued at par and allocated on a "first come first served basis". The targeted issuance volume was reached on 5 April.

In practical terms, investors could dial a specified code on their mobile phone, and follow the instructions to place a bid for the M-AKIBA Government bond using the provider's mobile platform. The bond was subsequently credited to the investor's account while the payment was deducted from the investor's "mobile wallet". Coupon payments are also credited to the holder's wallet and the principal is returned to the same wallet at maturity.

Secondary market: The mobile Government bond is listed on the Nairobi Securities Exchange (NSE) where it is tradable on the secondary market. The Commercial Bank of Africa (CBA) was designated as liquidity provider. Buy or sell orders are placed exclusively via mobile devices and are processed in real-time, and there are no restrictions in terms of volume. A transaction fee of 0.535% is applied on orders on the secondary market, and other charges of the network provider may apply.

Benefits and challenges: It is noteworthy that a smartphone is not a pre-requisite. The registration process including Know-Your-Customer (KYC) requirements and regulatory guidelines are verified in a few steps. As an additional incentive, interest income on this bond is exempt from tax.

However, a number of challenges remain. From a technical point of view, a majority of retail investors use basic mobile phones that do not support downloading the bond's disclosure documentation. In addition, technical glitches caused initial disruption of trading activity following the launch.

The M-Akiba Bond is primarily designed to be held to maturity as a savings instrument. This may not be suitable for investors who require instant access to cash, and the return may be lower than the initial investment if the bond is sold, including the effect of transaction fees. Also, the average bid size suggested that the Government debt was purchased by larger investors rather than retail investors.

Conclusion: The issuance process of a further tranche of the M-AKIBA bond was initiated on 30 June 2017. While the initial target volume was €8.5 million (KES 1bn), it is foreseen potentially to issue an additional €32.5 million (KES 3.85bn) depending on demand. The scheduled closing of the offer is on 21 July 2017. It will be interesting to follow the evolution of this novel way of issuing and trading bonds, which could perhaps serve as an example for other markets.

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58. A term broadly used to describe innovation in financial services enabled by technology.

59. Capital Markets Soundness Report, Kenya Capital Markets Authority (CMA), Volume II, p. 7.

Macroprudential risk

On 30 March 2017, the ESRB released issue 19 of its Risk Dashboard. The overview report indicates that in the latest quarter market indicators of systemic risks have remained stable. Considering macro risk, GDP growth across the European Union accelerated somewhat in the second half of 2016; albeit that the rate of unemployment remained unchanged in most EU countries over the last quarter and that relative debt levels continue to remain elevated across countries and sectors in the EU. With respect to credit risk, most EU countries have experienced credit growth over the last year, whilst lending standards remained broadly stable over the quarter. Concerning banks, profits have improved slightly compared to one year ago but remain low and disperse, whilst capitalisation of banks and their share of non- performing loans improved relative to last year; and in early- 2017 banks continued the trend of issuing less long-term debt. Meanwhile, the size of the non- banking part of the financial sector increased relatively to the size of credit institutions.

This release came alongside a press release reporting on the 25th regular meeting of the ESRB's General Board, held on 23 March. The General Board highlighted the repricing of risk premia in global financial markets as the main risk to financial stability in the EU. Moreover, the General Board endorsed the publication of the second EU Shadow Banking Monitor, which will be published in the coming months. The General Board exchanged views on the macroprudential measures taken in the EU in 2016, which are covered in the 3rd ESRB annual review of Macroprudential Policy in the EU, subsequently published on 13 April. The General Board also received an update on ongoing work by the ESRB High-Level Task Force on Safe Assets; and approved the adverse scenario prepared jointly by ECB staff and the ESRB Task Force on Stress Testing for the 2017 EU-wide stress test of IORPs by EIOPA. Separately, as of 7 April, the ESRB has updated its overview of national measures of macroprudential interest in the EU and the EEA.

On 3 April, the EBA published a periodical update of its Risk Dashboard summarising the main risks and vulnerabilities in the EU banking sector by a set of Risk Indicators in Q4 2016. EU banks' ratio of common equity tier 1 reached new highs, increasing by 20 bps to 14.2%, mainly explained by a decrease in RWAs. The ratio of NPLs was 5.1%, 30 bps below Q3 2016 and suggesting that supervisory efforts are bearing fruit, albeit slowly. Profitability remained squeezed, and the annualised RoE decreased to its lowest level of 3.3%, 2.1 percentage points below Q3; while the cost-to-income ratio continued to increase, reaching 65.7% up from 62.8% in the previous year. The average LCR was 141.1% in December 2016, well above the threshold defined as the requirement for 2016 (70%).

Published on 6 April, *Designing Frameworks for Central Bank Liquidity Assistance: Addressing New Challenges* is a report submitted by a CGFS working group. Given that liquidity assistance (LA) operations which took place during the 2007-09 global financial crisis presented central banks (CBs) with a number of challenges, this report considers three issues in particular: (i) the provision of LA to internationally active financial intermediaries; (ii) transparency about LA; and (iii) the provision of LA to a market. The overarching message is the need to prepare in calm times to be able to provide LA effectively in times of stress. A set of principles articulate this general message in the context of specific challenges. These cover the fact that CBs may be called to work closely with each other when providing LA to an internationally active financial intermediary. In terms of transparency, CBs should bear in mind the trade-offs between transparency and the need for flexibility in the timing of disclosures, to promote financial stability. Finally, CBs should seek to better understand the implications of the evolution of market-based forms of financial intermediation, as these channels are likely to play a key role in future episodes of systemic stress.

On 20 April, the Joint Committee of the ESAs published its spring 2017 *Report on Risks and Vulnerabilities in the European Union's Financial System*. This report highlights the risks to the stability of the European financial sector in an environment subject to political and economic uncertainties. In particular, the protracted period of low profitability of banks and the difficulties faced by insurers to generate adequate returns to meet long-term liabilities in a low growth and low-yield environment remains a major challenge. In addition, the steepening of the yield curve may benefit earnings across all sectors but it also raises valuation concerns and, in the short term, may not be sufficient to alleviate the low profitability concerns. The Report also highlights the high valuation risk linked to search for yield strategies and repricing of risk premia; and rising operational risks related to information and communication technologies are increasingly requiring supervisory attention.

Also published on 20 April, the 21st edition of the Banque de France Financial Stability Review (FSR) analyses the impact of financial reforms, eight years after the 2009 G20 action plan. With most elements of this plan now being finalised, concerns are being raised as to the potential negative effects of the new regulations, with some even questioning the need for robust global regulations to safeguard financial stability. In order to contribute to this debate and provide some factual clarifications, the FSR brings together the views of public authorities, academics and industry representatives. With the benefit of a few years' hindsight, and based on the results of several assessment exercises, the various contributions point to a twofold outcome for the G20 financial reforms: a major achievement and a demanding challenge. The achievement is that the regulatory reforms put in place since the crisis have made the global financial system substantially more resilient, with no noticeable adverse impact on economic growth. The challenge now is to finalise the regulatory framework and ensure its enforcement over the long term.

Additionally, on 20 April, the IMF held a press conference on the release of its April 2017 Global Financial Stability Report (GFSR). This report finds that financial stability has continued to improve since October 2016, as economic activity has gained momentum and longer-term interest rates have risen, helping to boost the earnings of banks and insurance companies. Despite these improvements, however, threats to financial stability are emerging from elevated political and policy uncertainty around the globe; and if policy developments in advanced economies make the path for growth and debt less benign than expected, risk premiums and volatility could rise sharply. In addition, a shift toward protectionism in advanced economies could reduce global growth and trade, impede capital flows, and dampen market sentiment; and hence getting the policy mix right is crucial. Furthermore, there should be no rollback of the post-crisis reforms that have strengthened oversight of the financial system. This GFSR also includes a chapter that examines how a prolonged low-growth, low-interest rate environment can fundamentally change the nature of financial intermediation; and another chapter assesses the ability of country authorities to influence domestic financial conditions in a financially integrated world.

Published on 1 May, *Macroprudential Liquidity Stress Testing in FSAPs for Systemically Important Financial Systems* is an IMF staff working paper. The authors observe that bank liquidity stress testing, which has become *de rigueur* following the costly lessons of the global financial crisis, remains underdeveloped compared to solvency stress testing. The ability to adequately identify, model and assess the impact of liquidity shocks, which are infrequent but can have a severe impact on affected banks and financial systems, is complicated not only by data limitations but also by interactions among multiple factors. In this paper, the authors provide a conceptual overview of liquidity stress testing approaches for banks and discusses their implementation by IMF staff in the Financial Sector Assessment Program (FSAP) for countries with systemically important financial sectors, over the last six years.

Do Stress Tests Matter? Evidence From the 2014 and 2016 Stress Tests is a working paper published by the ECB on 5 May. In this study, using an event study approach, the authors explore how market participants reacted to the 2014 Comprehensive Assessment and the 2016 EBA EU-wide stress test. The results show that stress test disclosures revealed new information that was priced by the markets. The authors also provide evidence that the publication of stress test results enhanced price discrimination; and provide some evidence that also sovereign funding costs were affected in the aftermath of the stress test publications.

On 10 May, the FSB published the Global Shadow Banking Monitoring Report 2016, which presents the results of the FSB's sixth annual monitoring exercise to assess global trends and risks in the shadow banking system, reflecting data up to the end of 2015. It covers 28 jurisdictions, including Belgium and the Cayman Islands for the first time, which together account for about 80% of global GDP. The monitoring exercise adopts the activity-based "economic function" approach where authorities narrow the focus to those parts of the non-bank financial sector where financial stability risks from shadow banking (such as maturity/liquidity mismatches and leverage) may arise and may need appropriate policy responses to mitigate these risks. While further refinements are needed going forward, the 2016 exercise deepened the analysis of this activity-based narrow measure of shadow banking by looking at its components and the potential risks in more detail.

The main findings from the 2016 exercise are as follows:

- the activity-based, narrow measure of shadow banking was US$34 trillion in 2015, increasing by 3.2% compared to

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The 2016 exercise collected new data to measure interconnectedness among the bank and the non-bank financial sectors and to assess the trends of short-term wholesale funding, including repos.

the prior year, and equivalent to 13% of total financial system assets and 70% of GDP of these jurisdictions;

- credit intermediation associated with CIVs comprised 65% of the narrow measure of shadow banking, growing by around 10% on average over the past four years – accompanied by liquidity and maturity transformation, and in the case of jurisdictions reporting hedge funds, relatively high level of leverage;
- non-bank financial entities engaging in loan provision that are dependent on short-term funding or secured funding of client assets, such as finance companies, represent 8% of the narrow measure, and grew by 2.5% in 2015 – in at least some jurisdictions, finance companies tended to have relatively high leverage and maturity transformation; and
- in 2015, the wider aggregate comprising "Other Financial Intermediaries" (OFIs) in 21 jurisdictions and the euro area grew to $92 trillion, from $89 trillion in 2014.

The 2016 exercise also collected new data to measure interconnectedness among the bank and the non-bank financial sectors and to assess the trends of short-term wholesale funding, including repos – while the data availability needs to be improved, the data collected suggested that on an aggregated basis, both banks' credit exposures to and funding from OFIs have continued to decline in 2015, although they remain above the levels before the 2007-09 financial crisis.

On 18 May, EIOPA launched its second (the first was in 2015) EU-wide stress test for the Institutions for Occupational Retirement Provision (IORPs). This stress test provides insight into the risks and vulnerabilities of the European occupational pensions sector, by assessing its resilience to an adverse market scenario using common methodologies. It will also analyse how IORPs transfer shocks, resulting from the impact of the adverse market scenario, to the real economy and financial markets. The stress scenario, referred to as "double-hit", was developed in cooperation with the ESRB and combines a drop in risk-free interest rates with a fall in the price of assets held by IORPs. The stress test covers both defined benefit and hybrid as well as defined contribution plans, and includes all EEA countries with material IORP sectors. The deadline for participating IORPs to complete the exercise is 13 July, with results planned to be published in an aggregated way by the end of 2017.

The EU Macroprudential Policy Framework is a, 23 May, briefing prepared for the European Parliament's ECON Committee, which provides an overview of this framework in its various components (ie the ESRB, the national macroprudential authorities, the ECB and its macroprudential supervisory competences in the Banking Union). It also mentions the upcoming review of the framework by the Commission, following the public consultation launched in August 2016. Alongside this, a second, 23 May, briefing paper was prepared for ECON, *The European Systemic Risk Board: Output Since Inception*. In addition, ECON received a, 19 May, study, *The Role of Macroprudential Policy in the Prevention and Correction of Divergences in the Euro Area*; and a, 19 May, in-depth analysis, *The Role of Macroprudential Policies in Prevention and Correction of Asset Imbalances in the Euro Area*.

On 24 May, the ECB published its latest semi-annual Financial Stability Review (FSR), which provides an overview of the possible sources of risk and vulnerability to financial stability in the euro area. Overall, the ECB reports that:

- repricing risks in fixed income markets remain significant;
- market pressure on euro area banks has receded amid persisting structural vulnerabilities;
- continued political uncertainty and potentially higher bond yields could trigger renewed debt sustainability concerns; and
- Brexit is not expected to pose significant financial stability risk to the euro area (see Box 1: Preparing for Brexit to secure the smooth provision of financial services to the euro area economy – at page 27).

The FSR singles out four main risks to financial stability in the euro area over the next two years:

1. repricing in global fixed income markets – triggered by changing market expectations about economic policies – leading to spillovers to financial conditions (medium-level systemic risk: same as in last FSR);
2. adverse feedback loop between weak bank profitability and low nominal growth, amid structural challenges in the euro area banking sector (medium-level systemic risk: same as in last FSR);
3. public and private debt sustainability concerns amid a potential repricing in bond markets and political uncertainty in some countries (medium-level systemic risk: increased since last FSR); and
4. liquidity risks in the non-bank financial sector with potential spillovers to the broader financial system (potential systemic risk: same as in last FSR).

All four risks are intertwined and, if they were to materialise, they would have the potential to be mutually reinforcing. A common trigger for all of these risks could be weaker nominal growth than currently expected across the euro area.

The Review also contains three special features. The first examines the decoupling observed recently between financial market conditions and economic policy uncertainty; the second presents an approach to identifying excessive household credit developments that relies on a concept of equilibrium debt based on fundamental economic factors; and the third highlights the potential role and benefits of several co-investment strategies for addressing NPLs involving the private and the public sector.

On 29 May, the ESRB published the second annual EU Shadow Banking Monitor, which presents an overview of developments in the European shadow banking system to identify risks to financial stability. The assessment presented in this year's report shows that the growth in broad EU shadow banking assets slowed markedly in 2016. In addition, the report highlights several risks and vulnerabilities which need to be monitored in the EU shadow banking system including:

- liquidity risk and risks associated with leverage among some types of investment funds (e.g. investment funds which invest in less liquid markets while offering daily redeemable shares or which are highly leveraged);
- interconnectedness and contagion risk across sectors and within the shadow banking system, including domestic and cross-border linkages;
- procyclicality, leverage and liquidity risk created through the use of derivatives and SFTs; and
- vulnerabilities in some parts of the other financial institutions sector, where significant data gaps prevent a definitive risk assessment.

Also on 29 May, the Chair of the ESRB, Mario Draghi, spoke at a hearing before the European Parliament's ECON Committee. In his introductory statement, he gave an overview of the risks highlighted by the *EU Shadow Banking Monitor*, before concluding with some observations as regards macroprudential policy in general – in which he covered macroprudential policy beyond banking and the ESRB's review of macroprudential policy in the EU in 2016.

On 7 June, the EBA published its 2018 EU-wide stress test draft methodology and templates for discussion with the industry. The exercise will cover 70% of the EU banking sector (a list of institutions participating was published) and will assess EU banks' ability to meet relevant supervisory capital ratios during an adverse economic shock. The methodology covers all relevant risk areas and, for the first time, will incorporate IFRS 9 accounting standards. The results will inform the 2018 Supervisory Review and Evaluation Process (SREP), challenging banks' capital plans and leading to relevant supervisory outcomes. The exercise will also provide enhanced transparency so that market participants can compare and assess the resilience of EU banks on a consistent basis. The final methodology will be published as the exercise is launched, at the beginning of 2018, and the results to be published in mid-year 2018.

Published on 8 June, *The International Dimensions of Macroprudential Policies* is a BIS working paper, prepared because the large economic costs associated with the global financial crisis have generated renewed interest in macroprudential policies and their international coordination. Based on a core-periphery model that emphasises the role of international financial centres, the authors study the effects of coordinated and non-coordinated macroprudential policies when financial intermediation is subject to frictions. They find that even when the only frictions in the economy consist of financial frictions and financial dependency of periphery banks, the policy prescriptions under international policy coordination can differ quite markedly from those emerging from self-oriented policy decisions. Optimal macroprudential policies must address both short run and long run inefficiencies. The gains from cooperation appear to be sizable. Nevertheless, their magnitude could be asymmetric, pointing to potential political-economy obstacles to the implementation of cooperative measures.

Published on 9 June, the biannual ECB Macroprudential Bulletin aims to increase awareness of and enhance transparency regarding the ECB's macroprudential policy work. With this intention in mind, the third issue of the Macroprudential Bulletin provides insights into the ECB's macroprudential tools and its thinking on macroprudential issues. The first chapter describes the ECB floor methodology for setting the O-SII capital buffer that each identified O-SII is required to maintain; the second chapter describes quality assurance as part of the 2016 Stress Test Exercise; and the last chapter develops some quantitative analysis regarding the EDIS, the third pillar of the Banking Union. And, as in previous issues, this Macroprudential Bulletin ends with an overview of recent announcements relating to macroprudential instruments in the euro area.

Also published on 9 June, *Simulating Fire-Sales in a Banking and Shadow Banking System* is an ESRB working paper, in which the authors develop an agent based model of traditional banks and asset managers. Their aim is to investigate the channels of contagion of shocks to asset prices within and between the two financial sectors, including the effects of fire sales and their impact on financial institutions' balance sheets. The authors show how, in their modelled set-up, an initial exogenous liquidity shock may lead to a fire-sale spiral. They find that, first, mixed portfolio banks act as plague-spreaders in a context of financial distress. Second, higher bank capital requirements may aggravate contagion; and third, asset managers absorb small liquidity shocks, but they exacerbate contagion when liquid buffers are fully utilised.

On 14 June, ESMA issued the most recent iteration of its Risk Dashboard, covering risks in the EU's securities markets for Q1 2017. ESMA's overall risk assessment remains unchanged from Q4 2016 at high levels, reflecting very high risk in securities markets, and elevated risk for investors, infrastructures and services. In Q1 2017, EU financial markets remained relatively calm with stable volatility and increasing equity market prices. EU sovereign bond yields continued to increase, by around 19 bps on average mirroring US Government bonds, however, yield developments were heterogeneous with potential reactivity to political events reflected in higher than average yield increases for some Member States. Investment fund liquidity remained a concern with strong bond and equity funds inflows, potentially subject to event-related reversals. While main risks remained high, ESMA's outlook for market, liquidity, credit and contagion risk is stable. The low yield environment and related sustained concerns with regard to excessive risk taking and asset pricing persisted; but going forward, ESMA considers political uncertainties as the most important potential sources of risk in 2017.

On 20 June, EIOPA published its latest Financial Stability Report of the (re) insurance and occupational pensions sectors in the EEA. According to the report, the European macroeconomic environment remains fragile, with some signs of improvement; and uncertainties stemming from the political environment as well as emerging risks pose challenges for both sectors. The report includes a thematic article on re-evaluation of the capital charge in insurance after a large shock.

Published on 20 June, *Macroprudential Policy and Bank Risk* is a BIS working papers which investigates the effects of macroprudential policies on bank risk through a large panel of banks operating in 61 advanced and emerging market economies. The authors reach three main findings. First, there is evidence suggesting that macroprudential tools have a significant impact on bank risk. Second, the responses to changes in macroprudential tools differ among banks, depending on their specific balance sheet characteristics. In particular, banks that are small, weakly capitalised and with a higher share of wholesale funding react more strongly to changes in macroprudential tools. And, third, controlling for bank-specific characteristics, macroprudential policies are more effective in a tightening than in an easing episode.

The General Board of the ESRB held its 26th regular meeting, on 22 June. The General Board highlighted the repricing of risk premia in global financial markets as the main risk to financial stability in the EU. The General Board also noted that risks to the baseline scenario have been reduced, with economic growth becoming more broad-based and financial market sentiment improving. Despite the improving baseline scenario, tail risks remain elevated amid geopolitical and policy uncertainties, both in the global economy and in Europe. These uncertainties could act as potential triggers for a repricing of risk premia in global financial markets.

The General Board also endorsed the publication of an ESRB report on resolving NPLs in the EU; and considered the financial stability implications of the implementation of IFRS 9. Furthermore, the General Board exchanged views on the macroprudential aspects of the recovery and resolution regime for CCPs and endorsed an opinion in this regard; and endorsed an ESRB report on recovery and resolution frameworks in insurance. Finally, the General Board endorsed the publication of an ESRB report discussing regulatory yield curves in insurance and their macroprudential consequences.

The UK Financial Policy Committee (FPC) prepares and publishes a Financial Stability Report (FSR) twice per calendar year. To do this, the FPC identifies the risks faced by the UK financial system and weighs them against the resilience of the system. The latest such FSR was published on 27 June. The FPC assesses the overall risks from the domestic environment to be at a standard level, with most financial stability indicators being neither particularly elevated nor subdued. Yet, as is often the case in a standard environment, there are pockets of risk that warrant vigilance. In addition, Brexit creates uncertainty, as there are a range of possible outcomes for, and paths to, the UK's withdrawal from the EU. Measures of market volatility and the valuation of some assets, including corporate bonds, do not appear to reflect fully the downside risks that are implied by very low long-term interest rates. To ensure that the financial system has the resilience it needs, the FPC reports a number of actions which are being taken.

On 29 June, the ESRB released issue 20 of its Risk Dashboard. The overview report indicates that in the latest quarter market indicators of systemic risks have remained at low levels. Considering macro risk, economic recovery in the EU has continued in Q1 2017, with the majority of EU countries having now experienced faster economic growth than they had on average in the last three years. With respect to credit risk, there has been higher credit growth to households and non-financial companies in the EU, with growth rates now higher in the majority of the countries in comparison with the same period last year and increasing rapidly in some countries. Concerning banks, profitability in the EU remains weak, but improved in Q1 2017 compared to one year ago, while median capitalisation of EU banks increased somewhat in Q1 2017 and their share of non-performing loans has improved. Meanwhile, the size of the non-banking part of the financial sector increased in 2016 relative to the total assets of credit institutions.

Wholesale Funding Dry-Ups is an ESRB working paper, published on 30 June. The authors empirically explore the fragility of wholesale funding of banks, using transaction level data on short-term, unsecured certificates of deposits in the European market. They do not observe any market-wide freeze during the 2008-2014 period; yet, many banks do suddenly experience funding dry-ups. Dry-ups predict, but do not cause, future deterioration of bank performance. Furthermore, in periods of market stress, banks with high future performance tend to increase reliance on wholesale funding. Thus, the authors fail to find evidence consistent with classical adverse selection models of funding market freezes. Rather, their evidence is in line with theories highlighting heterogeneity between informed and uninformed lenders.

Also published on 30 June, *Towards Macroprudential Stress Testing: Incorporating Macro-Feedback Effects* is an IMF staff working paper, prompted by the fact that macro-feedback effects have been identified as a key missing element for more effective macroprudential stress testing. To fill this gap, in this paper the authors develop a framework that facilitates the analysis of both the direct effects of macroeconomic shocks on the solvency of individual banks and feedback effects that allow for the amplification and propagation of shocks that can result from bank deleveraging and credit crunches. The framework ensures consistency in the key relationships between macroeconomic and financial variables, and banks' balance sheets. This is accomplished by embedding a standard stress-testing framework based on individual banks' data in a semi-structural macroeconomic model. This framework has numerous applications that can strengthen stress testing and macro financial analysis. Moreover, it provides an avenue for many extensions that address the challenges of incorporating other second-round effects important for comprehensive systemic risk analysis, such as interactions between solvency, liquidity and contagion risks; and hence this paper also presents some preliminary simulations of feedback effects arising from the link between the liquidity and solvency risk.

In response to a request from the G20, on 3 July, the FSB published an assessment of the evolution of shadow banking activities and risks since the global financial crisis, and the adequacy of post-crisis policies and monitoring to address these risks. This assessment highlights that the aspects of shadow banking considered to have contributed to the global financial crisis have declined significantly and generally no longer pose financial stability risks. The assessment also describes how, since the financial crisis, policies have been introduced to address financial stability risks from shadow banking. However, a rise in assets held in certain investment funds has increased the risks from liquidity transformation. These developments underscore the importance of effective operationalisation and implementation of the FSB's January 2017 policy recommendations to address structural vulnerabilities from asset management activities. At present, the FSB has not identified other new financial stability risks from shadow banking that would warrant additional regulatory action at the global level. However, since shadow banking evolves over time, authorities should continue to monitor vigilantly and address promptly emerging financial stability risks. To these ends FSB member authorities have agreed the following recommendations: enhance system-wide oversight of shadow banking and policy responses to address the identified risks; strengthen the monitoring of shadow banking activities and data collection; and complete the remaining policy development at the international level and implement the agreed policy recommendations to reduce risks and arbitrage opportunities across jurisdictions and sectors.

Published on 16 June, *Fintech and Financial Services: Initial Considerations* is an IMF staff discussion note, which reviews developments in the new wave of technological innovations, often called "FinTech," and assesses their impact on an array of financial services. Given the IMF's mandate to promote the stability of the international monetary system, it focuses on rapidly changing cross-border payments. Using an economic framework, the paper discusses how fintech might provide solutions that respond to consumer needs for trust, security, privacy, better services, and change the competitive landscape. Key findings include that boundaries are blurring among intermediaries, markets, and new service providers; barriers to entry are changing; trust remains essential; and technologies may improve cross-border payments. Policy making will need to be nimble, experimental, and cooperative. In particular, regulators may need to complement their focus on entities with increasing attention to activities; governance needs to be strengthened; policy options to support open networks could be considered; and legal principles need to be modernised.

As FinTech platforms account for an increasing share of credit provision, policymakers have to consider the opportunities and risks such activity brings. A, 22 May, report by the CGFS and the FSB analyses the nature of FinTech credit and finds wide variation in the business models of the electronic platforms involved. More broadly, on 27 June, the FSB reported on its analysis of the potential financial stability implications from FinTech. The FSB has sought to identify supervisory and regulatory issues that merit authorities' attention. Ten areas have been identified, of which the following three are seen as priorities for international collaboration: (i) the need to manage operational risk from third-party service providers; (ii) mitigating cyber risks; and (iii) monitoring macrofinancial risks that could emerge as FinTech activities increase. Addressing these priority areas is seen as essential to supporting authorities' efforts to safeguard financial stability while fostering more inclusive and sustainable finance.

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ICMA Capital Market Research

The European Credit Repo Market: The Cornerstone of Corporate Bond Market Liquidity
Published: 22 June 2017
Author: Andy Hill, ICMA

Closed for Business: A Post-Mortem of the European Repo Market Break-Down over the 2016 Year-End
Published: 14 February 2017
Author: Andy Hill, ICMA

The Counterparty Gap: A study for the ICMA European Repo and Collateral Council on the Trade Registration Models used by European Central Counterparties for Repo Transactions
Published: 27 September 2016
Author: Prepared for ICMA by John Burke, independent consultant

Remaking the Corporate Bond Market: ICMA's 2nd Study into the State and Evolution of the European Investment Grade Corporate Bond Secondary Market
Published: 6 July 2016
Author: Andy Hill, ICMA

Evolutionary Change: The Future of Electronic Trading in European Cash Bonds
Published: 20 April 2016
Author: Elizabeth Callaghan, ICMA

Perspectives from the Eye of the Storm: The Current State and Future Evolution of the European Repo Market
Published: 18 November 2015
Author: Andy Hill, ICMA

Impact Study for CSDR Mandatory Buy-ins
Published: 24 February 2015
Author: Andy Hill, ICMA

The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market
Published: 25 November 2014
Author: Andy Hill, ICMA

Continually Working to Develop Efficient and Effective Collateral Markets
ERC Occasional Paper
Published: 4 September 2014
Author: David Hiscock, ICMA

Covered Bond Pool Transparency: the Next Stage for Investors
Published: 21 August 2014
Author: Prepared for ICMA by Richard Kemmish Consulting Ltd

Collateral is the New Cash: The Systemic Risks of Inhibiting Collateral Fluidity
Published: 3 April 2014
Author: Andy Hill, ICMA

Avoiding Counterproductive Regulation in Capital Markets: A Reality Check
Published: 29 October 2013
Author: Timothy Baker, Senior Adviser to ICMA

Collateral Damage: the Impact of the Financial Transaction Tax on the European Repo Market and its Consequences for the Financial Markets and the Real Economy
Published: 8 April 2013
Author: Richard Comotto, ICMA Centre

Economic Importance of the Corporate Bond Markets
Published: 8 April 2013
Author: Timothy Baker, Senior Adviser to ICMA

Events & Education

New ICMA Mentoring Platform

The new ICMA Mentoring Platform is designed to help individuals at member firms develop their skills by matching those looking for a career mentor with suitable mentors in the international capital market.

It is built on mentoring and e-learning tools, that not only help to match mentors with mentees, but also support them with a wide range of learning and development resources that are accessible from your smartphone, tablet, laptop or desktop computer.

Open to all employees of all ICMA's 500+ member firms the platform matches mentors and mentees based on their specified criteria.

Mentors and mentees can:

- interact as much or as little as they wish, from an hour per month;
- specify how they wish to interact: by email, phone, skype, face to face etc;
- specify the areas where they can help (mentors) or where they need career advice (mentees), including, improvement of management or communication skills, insight into specific capital market segments and more.

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Get Involved! An ICMA Future Leaders guide for young professionals in the international capital market

To help members to get the most out of their engagement with ICMA we have produced Get involved!, a quick guide to what ICMA does and how it works with its members. This has been prepared by the members of the ICMA Future Leaders Committee, who are all professionals in the early stages of their careers, to provide an insight into the work of the association and the services it offers.

Open up Get involved! for quick links to all our services.

- Find out how ICMA brings together the borrower, buy-side, sell-side and investor communities and how to join them.
- Take advantage of our regionally based networking by signing up for the Future Leaders or Women's Network.
- Follow us on social media and sign up for our newsletters to keep in touch with the latest regulatory developments.
- Join the new ICMA mentoring platform.
- Get fast access to our standard documentation for primary, secondary and repo markets.

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More than 1,000 delegates joined us in Luxembourg in May for the Annual General Meeting and Conference. Featured speakers included: Xavier Bettel, Prime Minister, Luxembourg; Pierre Gramegna, Minister of Finance, Luxembourg; Yves Mersch, Member of the Executive Board, European Central Bank; Steven Maijoor, Chair, European Securities and Markets Authority (ESMA); Werner Hoyer, President, European Investment Bank; and Philipp Hildebrand, Vice Chairman and Member of the Global Executive Committee, BlackRock, on a broad range of capital market themes including green finance, regulation and FinTech.

SAVE THE DATE for the 50th ICMA AGM and Conference: Madrid, 30 May to 1 June 2018.

ICMA Women's Network
Networking. Progression. Support.

ICMA Women's Network: Getting noticed

After welcome remarks from Sun-Hee Park of EBRD, the host venue for the event, and Nannette Hechler Fayd'herbe, Head of Investment Strategy and Research, Credit Suisse and member of the ICMA Board, the ICMA Women's Network summer event got underway.

Howard Kingston, an expert in social media and the evening's speaker, made a memorable first impression – he bounded on to the stage and was vibrant, energetic and dynamic, promising an interactive and fun evening. He explained not only what a personal brand is, but why it matters so much.

With the changing times dictated by technology, we cannot get away from the fact that we are in a generation where we are represented on-line, whether we like it or not. Howard's definition of a personal brand is "a desired perception", which we are in control of optimising to get the right exposure and maximum opportunities. So, it is imperative to ensure that what appears about us on-line is exactly how and what we want to appear; we only get one chance to give a first impression and Howard advised us how to curate that in a truthful but impressive way.

He explained how our LinkedIn profile should detail our strengths, recommending ways of identifying what these are (by reference to friends, colleagues or to self-help books). Employers and other users looking for experts on-line rely heavily on on-line profiles, so relevant "keywords" should be used and repeated in titles, bodies of text, examples of experience, and in our skills set, which should help to maximise the number of people not only looking for us, but actually finding us - "being a magnet", in Howard-speak! However, while there is no harm in collecting as many contacts as we like, even acquaintances, one should be conscious of exercising some discernment when approaching new connections.

On-line safety is, of course, very important, such as having the foresight to shield your professional audience from your personal social media profile. Here, the lesson is to differentiate your audience and use the maximum privacy settings to prevent tainting your public profile or turning into a viral YouTube video!

It was not just about having a personal brand. There are so many on-line resources, apps and ways of impressing others. Knowing who you are meeting, whether for an important client pitch, interview, or even a date, can be enhanced by an app that connects to your calendar and researches the person you are meeting.

Even the most tech savvy, social media addicts in the room would have learned something. Afterwards, the discussion continued during the structured networking over drinks and canapés. Howard stayed and shared his expertise until the end, which rounded off another successful evening for the IWN's growing group of members. I am sure a lot of us went straight on-line afterwards to check our privacy settings, enhance our on-line profiles with keywords and check out those recommended websites and resources.

Fiona Kowalyk, Barclays
IWN Steering Committee

Diary 2017

DATE	
19 July *Register*	**ICMA Future Leaders Summer Networking Reception London 19 July** ICMA's Future Leaders has gone from strength to strength since its launch two years ago with an ever-increasing number of young professionals among the ICMA membership becoming more involved in its activities. The IFL's contributions to ICMA's outreach to the young generation has also been significant with the launch of the ICMA app, the guide for young professionals in the international capital market ("Get Involved") and the ICMA mentoring platform. A series of networking and career progression events are run throughout the year by the IFL in major financial centres across Europe. The next Future Leaders event in London will be an evening networking reception at the rooftop terraces of Rabobank, which will feature the Chairman of ICMA and Global Co-Head of Primary & Credit Markets at BNP Paribas, Martin Egan.

ICMA Workshops

6 September **4 October** **26 October** *Register*	**ICMA MiFID II/R Implementation Workshops** The January 2018 MiFID II/R implementation date is approaching and market participants are immersed in preparations for MiFID II/R. With this in mind, ICMA will be holding MiFID II/R implementation workshops across Europe. These workshops will assist buy-side and sell-side bond traders in assessing whether they are on the same track as their counterparts in other regions. The workshops will also facilitate discussions on local implementation challenges and interpretations as well as the sharing of information. These workshops are for bond trading participants who are heavily focused on the transparency, best execution and the research obligations of MiFID II/R, as well as the newly emerging market structure trends, such as innovative protocols and platforms. Panels will feature international and local experts from the buy side and sell side. ICMA's MiFID II/R workshops will be interactive and will assume an audience with a working knowledge of cash bond trading and MiFID II/R related obligations. MiFID II/R Implementation Workshop schedule: • 6 September: Stockholm • 4 October: Brussels • 26 October: Frankfurt Check the ICMA website for more locations including Milan, Madrid and Paris.
5 October *Register*	**European Regulation: An Introduction for Capital Market Practitioners, London, 5 October** Against a background of far-reaching regulatory change ICMA's one-day, fast-track course on European regulation for capital market practitioners gives an overview of the new regulatory landscape for financial institutions in Europe. It puts the major European regulatory initiatives into the context of the global reforms agreed by the G20 and explains the European legislative process, while looking at specific regulations affecting the capital framework of banks, investor protection and disclosure.

Diary 2017

DATE	
1 November *Register*	**Bond Syndication Practices for Compliance Professionals and Other Non-bankers, London, 1 November** This workshop aims to give compliance professionals an in-depth and thorough understanding of the practices that are involved in launching a deal in the international debt capital market. It explains precisely how the deal is done, starting with first steps in the pre-launch process – looking at the pitch book, the mandate, the roadshow and the prospectus - through syndication, including book building and allocation, up to and including the final public launch of the issue.

ICMA Conferences

13 September *Register*	**Building the Russian Capital Market – Developments and Initiatives, Moscow, 13 September** ICMA and NFA, the leading securities market trade association in Russia, will present key initiatives and developments in the Russian and international capital market. Representatives from the Bank of Russia and other capital market experts from both Europe and Russia will look at the role of capital markets in funding economic growth, developments in the repo and collateral market and the efforts being taken to build on the current investor protection framework.
8 November *Register*	**ICMA Asset Management and Investors Council Conference, London, 8 November** The AMIC meeting, open to all on the buy side, is held twice a year and offers an opportunity to find out what the international investment community is thinking about on a range of market issues. Topics to be covered at the meeting in November will include: Future of the asset management industry; Research unbundling in MiFID II; and Use of leverage in investment funds.
14 November *Register*	**ICMA European Repo and Collateral Council General Meeting, Brussels, 14 November** The Autumn 2017 General Meeting will be used as an opportunity to deepen the exchange of ideas between the market, the public sector and academia at this critical time in the post-crisis programme of regulatory reform. Between keynote addresses from the IMF and the ECB, there will be two panel discussions, involving industry representatives, regulators and academics looking at general market conditions and operational challenges for repo markets.

ICMA Executive Education

Courses 2017

ONLINE COURSES STARTING EVERY MONTH!

Due to increased demand, we have increased the availability of our online learning courses and you can now sign up for our online programmes at the beginning of every month. Sign up now for the Financial Markets Foundation Qualification (FMFQ) Online Programme, Securities Operations Foundation Qualification (SOFQ) Online Programme and ICMA Fixed Income Certificate (FIC) Online Programme and start studying from 1 August!

This year we will also be holding our 5-day classroom based Fixed Income Certificate (FIC) course for the first time in Amsterdam. The course will take place from 23-27 October and registration is already open for the programme.

Book now for ICMA Executive Education programmes in 2017.

Foundation Qualifications

Financial Markets Foundation Qualification (FMFQ) Online
Next start date: **Tuesday 1 August** (register by Friday 28 July)

Securities Operations Foundation Qualification (SOFQ) Online
Next start date: **Tuesday 1 August** (register by Friday 28 July)

Introduction to Primary Markets Qualification (IPMQ)
London: **29 November – 1 December 2017**

Introduction to Fixed Income Qualification (IFIQ)
London: **11-13 October 2017**

Securities Operations Foundation Qualification (SOFQ)
Brussels: **15-17 November 2017**

Financial Markets Foundation Qualification (FMFQ)
London: **6-8 November 2017**

Advanced Qualifications

ICMA Fixed Income Certificate (FIC) Online
Next start date: **Tuesday 1 August** (register by Friday 28 July)

ICMA Operations Certificate Programme (OCP)
Brussels: **20-24 November 2017**

ICMA Fixed Income Certificate (FIC)
Amsterdam: **23-27 October 2017**

ICMA Primary Market Certificate (PMC)
Frankfurt: **18-21 September 2017**
London: **27 November – 1 December 2017**

Training Programmes

Collateral Management
London: **25-26 October 2017**

Trading & Hedging Short-term Interest Rate Risk
London: **16-17 October 2017**

Trading the Yield Curve with Interest Rate Derivatives
London: **18-19 October 2017**

Corporate Actions – An Introduction
London: **2-3 November 2017**

Credit Default Swaps – Pricing, Application & Features
London: **28-29 November 2017**

Credit Default Swaps – Operations
London: **30 November 2017**

Securitisation – An Introduction
London: **22-23 November 2017**

Securities Lending & Borrowing – Operational Challenges
London: **11-12 December 2017**

The ICMA Guide to Best Practice in the European Repo Market
London: **27 November 2017**

Fixed Income Portfolio Management
London: **9-10 November 2017**

Inflation-linked Bonds and Structures
London: **13-14 November 2017**

For more information, please contact: education@icmagroup.org or visit www.icmagroup.org/education

ABCP	Asset-Backed Commercial Paper
ABS	Asset-Backed Securities
ADB	Asian Development Bank
AFME	Association for Financial Markets in Europe
AIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
ASEAN	Association of Southeast Asian Nations
AuM	Assets under management
BBA	British Bankers' Association
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BMCG	ECB Bond Market Contact Group
bp	Basis points
BRRD	Bank Recovery and Resolution Directive
CAC	Collective action clause
CBIC	ICMA Covered Bond Investor Council
CCBM2	Collateral Central Bank Management
CCP	Central counterparty
CDS	Credit default swap
CFTC	US Commodity Futures Trading Commission
CGFS	Committee on the Global Financial System
CICF	Collateral Initiatives Coordination Forum
CIF	ICMA Corporate Issuer Forum
CMU	Capital Markets Union
CNAV	Constant net asset value
CoCo	Contingent convertible
COGESI	Contact Group on Euro Securities Infrastructures
COP21	Paris Climate Conference
COREPER	Committee of Permanent Representatives (in the EU)
CPMI	Committee on Payments and Market Infrastructures
CPSS	Committee on Payments and Settlement Systems
CRA	Credit Rating Agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
CSDR	Central Securities Depositories Regulation
DMO	Debt Management Office
D-SIBs	Domestic systemically important banks
DVP	Delivery-versus-payment
EACH	European Association of CCP Clearing Houses
EBA	European Banking Authority
EBRD	European Bank for Reconstruction and Redevelopment
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Economic and Financial Affairs Council (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
ECPC	ICMA Euro Commercial Paper Committee
EDGAR	US Electronic Data Gathering, Analysis and Retrieval
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Financial Stability Facility
EFSI	European Fund for Strategic Investment
EFTA	European Free Trade Area
EGMI	European Group on Market Infrastructures
EIB	European Investment Bank
EIOPA	European Insurance and Occupational Pensions Authority
ELTIFs	European Long-Term Investment Funds
EMDE	Emerging market and developing economies
EMIR	European Market Infrastructure Regulation
EMTN	Euro Medium-Term Note
EMU	Economic and Monetary Union
EP	European Parliament
ERCC	ICMA European Repo and Collateral Council
ESA	European Supervisory Authority
ESG	Environmental, social and governance
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund
ETP	Electronic trading platform
ESG	Environmental, social and governance
EU27	European Union minus the UK
ETD	Exchange-traded derivatives
EURIBOR	Euro Interbank Offered Rate
Eurosystem	ECB and participating national central banks in the euro area
FAQ	Frequently Asked Question
FASB	Financial Accounting Standards Board
FATCA	US Foreign Account Tax Compliance Act
FATF	Financial Action Task Force
FCA	UK Financial Conduct Authority
FEMR	Fair and Effective Markets Review
FICC	Fixed income, currency and commodity markets
FIIF	ICMA Financial Institution Issuer Forum
FMI	Financial market infrastructure
FMSB	FICC Markets Standards Board
FPC	UK Financial Policy Committee
FRN	Floating-rate note
FSB	Financial Stability Board
FSC	Financial Services Committee (of the EU)
FSOC	Financial Stability Oversight Council (of the US)
FTT	Financial Transaction Tax
G20	Group of Twenty
GBP	Green Bond Principles
GDP	Gross Domestic Product
GMRA	Global Master Repurchase Agreement
G-SIBs	Global systemically important banks
G-SIFIs	Global systemically important financial institutions
G-SIIs	Global systemically important insurers
HFT	High frequency trading
HMRC	HM Revenue and Customs
HMT	HM Treasury
HQLA	High Quality Liquid Assets
HY	High yield
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICMA	International Capital Market Association
ICSA	International Council of Securities Associations
ICSDs	International Central Securities Depositaries
IFRS	International Financial Reporting Standards
IG	Investment grade
IIF	Institute of International Finance
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IMFC	International Monetary and Financial Committee
IOSCO	International Organization of Securities Commissions
IRS	Interest rate swap
ISDA	International Swaps and Derivatives Association
ISLA	International Securities Lending Association
ITS	Implementing Technical Standards
KfW	Kreditanstalt f-r Wiederaufbau
KID	Key information document
KPI	Key performance indicator
LCR	Liquidity Coverage Ratio (or Requirement)
L&DC	ICMA Legal & Documentation Committee
LEI	Legal Entity Identifier
LIBOR	London Interbank Offered Rate
LTRO	Longer-Term Refinancing Operation
MAD	Market Abuse Directive
MAR	Market Abuse Regulation
MEP	Member of the European Parliament
MiFID	Markets in Financial Instruments Directive
MiFID II/R	Revision of MiFID (including MiFIR)
MiFIR	Markets in Financial Instruments Regulation
MMCG	ECB Money Market Contact Group
MMF	Money market fund
MOU	Memorandum of Understanding
MREL	Minimum requirement for own funds and eligible liabilities
MTF	Multilateral Trading Facility
NAFMII	National Association of Financial Market Institutional Investors
NAV	Net asset value
NCA	National competent authority
NCB	National central bank
NPL	Non-performing loan
NSFR	Net Stable Funding Ratio (or Requirement)
OAM	Officially Appointed Mechanism
OJ	Official Journal of the European Union
OMTs	Outright Monetary Transactions
ORB	London Stock Exchange Order book for Retail Bonds
OTC	Over-the-counter
OTF	Organised Trading Facility
PCS	Prime Collateralised Securities
PD	Prospectus Directive
PMPC	ICMA Primary Market Practices Committee
PRA	UK Prudential Regulation Authority
PRIIPs	Packaged Retail and Insurance-Based Investment Products
PSEs	Public Sector Entities
PSI	Private Sector Involvement
PSIF	Public Sector Issuer Forum
QE	Quantitative easing
QIS	Quantitative impact study
QMV	Qualified majority voting
RFQ	Request for quote
RFR	Risk-free interest rate
RM	Regulated Market
RMB	Chinese renminbi
ROC	Regulatory Oversight Committee of the Global Legal Entity Identifier System
RPC	ICMA Regulatory Policy Committee
RSF	Required Stable Funding
RSP	Retail structured products
RTS	Regulatory Technical Standards
RWA	Risk-weighted assets
SEC	US Securities and Exchange Commission
SFT	Securities financing transaction
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SLL	Securities Law Legislation
SMEs	Small and medium-sized enterprises
SMPC	ICMA Secondary Market Practices Committee
SMSG	Securities and Markets Stakeholder Group (of ESMA)
SPV	Special purpose vehicle
SRB	Single Resolution Board
SRM	Single Resolution Mechanism
SRO	Self-regulatory organisation
SSAs	Sovereigns, supranationals and agencies
SSM	Single Supervisory Mechanism
SSR	EU Short Selling Regulation
STORs	Suspicious transactions and order reports
STS	Simple, transparent and standardised
T+2	Trade date plus two business days
T2S	TARGET2-Securities
TD	EU Transparency Directive
TFEU	Treaty on the Functioning of the European Union
TLAC	Total Loss-Absorbing Capacity
TMA	Trade matching and affirmation
TRs	Trade repositories
UKLA	UK Listing Authority
VNAV	Variable net asset value

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