

ICMA quarterly report

Assessment of Market Practice
and Regulatory Policy

Issue 24
First Quarter 2012
Editor: Paul Richards

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ICMA

International Capital Market Association

12 January 2012

Managing market uncertainty

There has been only one story in the past year – how is the sovereign debt situation going to be resolved? This is the most severe threat to the stability of the European Union and the future of the euro since its inception, and to the future of the European capital markets as a whole. Ultimately this is a political crisis – and it is important that our leaders are willing to act, to make the necessary commitments and explain them to their electorates.

**Foreword by
Martin Scheck,
Chief Executive, ICMA**



The all-consuming focus on solving this issue is, however, masking a major change in the way the international capital markets (and participants in those markets) will be regulated, and the way they will operate in the future. These far-reaching regulatory proposals make significant demands on market participants, requiring them to focus their time and attention on fully comprehending the detail and its potential impact on their business prior to implementing whatever change is required. Equally the proposals require a very broad understanding of the way that different parts of the market are integrated with one another in order to ensure that perfectly sensible changes in one area, which our members might naturally be inclined to support, do not damage the way the markets work in other areas.

Much of the revision to securities regulation is directed towards changing dramatically the way the markets operate, with the laudable objectives of fundamentally increasing the level of consumer protection, reducing counterparty risk and providing greater levels of transparency. This involves, amongst other measures, encouraging the OTC markets to move to new, as yet undefined, organised venues and changing many of the processes and mechanics in other segments of the capital markets.

We all know that the capital markets are not working well at the moment - capital is not flowing from those who have it to those who need it; liquidity is vastly reduced or non-existent, screen prices are not adhered to; settlement issues abound; bid/offer spreads are wide; and investors are scrutinising the terms and conditions of bonds as they have not had occasion to before. These conditions arise mainly from the continuing crisis, but are exacerbated by ongoing regulatory uncertainty and the lack of clarity over much of the detail of the new regulation.

Against this backdrop it is unsurprising that ICMA can look back on an exceptionally active year, fully engaged with members through many committees and working groups, as we have sought to assess the true impact of proposed changes and to provide information and comment to regulators and policy makers. The breadth and geographic spread of our highly diverse membership base of issuers, intermediaries and investors in the international debt capital market uniquely equips ICMA to provide a measured and balanced view of the market, as well as the detailed technical input so urgently needed by the authorities.



ICMA can look back on an exceptionally active year, fully engaged with members through many committees and working groups, as we have sought to assess the true impact of proposed changes and to provide information and comment to regulators and policy makers.

ICMA initiatives in 2012

Looking ahead, where do we expect to be directing our resources in 2012?

The primary debt markets remain a critical focus: market practices have been under discussion in 2011 and will continue to be so in 2012. The extensive review and update of our Primary Market handbook will be completed during the first half of the year. We need to continue our work on the Prospectus Directive too, while also focusing on changes to the Market Abuse Directive. The Financial Institutions Issuer Forum continues to develop, and in early 2012 we will also start a new Public Sector Issuer Forum for the sovereign, supranational and agency sector.

Similarly we will be reviewing and updating our Secondary Market Rules and Recommendations in 2012, with a particular focus on those areas currently under stress, for example the sections relating to settlement discipline. We have reinvigorated our Secondary Market Practices Committee under the leadership

of a new chairman. The Committee will be busy with the review, with the work on MiFID and MiFIR, as well as considering the related changes in market infrastructure.

2011 was a milestone year for our repo activities with the finalisation of an 18 month review of the Global Master Repurchase Agreement and the launch of the updated GMRA 2011. Secured lending is now very much the market focus, both at the long and short ends of the yield curve. Our members are increasingly concerned at the growing scarcity of collateral, at a time when the demand for it is rising as a result of regulatory change, one-way collateral arrangements and the heightened mistrust of bank senior unsecured funding. We expect to devote more time considering these collateral issues over the next 12 months.

Our legal help desk has been answering a record number of member enquiries during the past few months, many related to the impact on euro debt securities and repo arrangements in the hypothetical case

of a euro area member exiting the euro, and what amendments or clarifications in standard market documentation might be considered in future transactions. We expect this work on contingency planning to continue.

Secured lending has also been a major theme of our buy-side work, with the ICMA Covered Bond Investor Council launching its initiative for increased transparency in the covered bond sector. This is progressing well and will see the issue of a transparency standard template in 2012. Our buy-side activity through the Asset Management and Investors Council continues to develop with initiatives in the areas of corporate governance, ETF transparency, valuation transparency, private banking standards and the reporting obligations of asset managers under Solvency II on insurance.

We have been delighted to see that this year again our membership numbers have increased. We finish the year with 433 members in 50 different countries compared with 400 at the beginning of the year. I extend a warm welcome to all those new members.

In conclusion I would like to thank not only the staff of ICMA but also the many hundreds of individuals from our members who give up their time freely to sit on our board, committees, councils, working groups. Without them we would simply not be effective - thank you.

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Quarterly Assessment by Paul Richards

Resolving the euro crisis

The key condition for restoring confidence in the international capital market in Europe remains the resolution of the sovereign debt and banking crisis in the euro area, which has become the centre of the international financial crisis. This Quarterly Assessment – an update of the previous one – considers the issues that need to be resolved and possible ways of resolving them, taking account of developments up to the end of the fourth quarter.

During the fourth quarter the euro crisis, which was previously a problem only on the periphery of the euro area, spread towards its core. Sovereign bond yields (eg in Italy and Spain) rose to levels which could become unsustainable, if not quickly reversed; yield spreads over bunds rose to levels unprecedented since the introduction of the euro; and there was even a rise in the spreads over bunds on other triple A-rated euro-area sovereign issuers. Credit rating agencies announced a series of sovereign rating downgrades and warnings. During the fourth quarter, the euro also weakened against the US dollar in the foreign exchange market.

The table shows government bond yields inside and outside the euro area at the end of the fourth quarter, spreads over bunds and changes in yields during 2011 as a whole.

Government bond yields*			
% PER ANNUM	YIELD END-2011	SPREAD OVER BUNDS	YIELD CHANGE ON END-2010
Germany	1.83	-	-1.19
Netherlands	2.21	0.38	-0.95
Finland	2.30	0.47	-0.89
Austria	3.10	1.27	-0.39
France	3.17	1.34	-0.26
Belgium	4.10	2.27	+0.11
Spain	5.09	3.26	-0.35
Italy	7.02	5.19	+2.14
Ireland	8.52	6.69	-0.71
Portugal	13.56	11.73	+6.85
Greece	33.97	32.14	+21.47
Switzerland	0.69	-1.14	-1.08
UK	1.98	0.15	-1.59
US	1.88	0.05	-1.46
Japan	0.98	-0.85	-0.18

Note: * 10 years approx. Source: FT, Thomson Reuters.

Summary of the problem

The underlying problem in the euro area that needs to be resolved can be summarised as follows:

- Some countries (eg Greece) did not meet the economic convergence criteria on a sustainable basis when they joined the euro area in the first place. Since the launch of the euro, experience within the euro area has not so far promoted greater economic convergence, but greater divergence. As a result, the external competitiveness of debtor countries in the euro area has deteriorated. This has led to large imbalances on the current account of the balance of payments between Germany (with a current account surplus of around 5% of GDP) and the peripheral euro-area economies; and it has led to imbalances in TARGET2, as a result of which the Bundesbank's net creditor position in the Eurosystem is estimated to have risen to around €400 billion (by last August).
- The Stability and Growth Pact (SGP) has not so far been enforced, leading to higher budget deficits in the euro area than the 3% limit originally agreed. Even in the case of countries (eg Ireland and Spain) which did keep their budget deficits within the SGP before the crisis began, the stimulus given to the private sector by low euro interest rates led to property booms which proved unsustainable, with the result that their budget deficits have now substantially increased (reflecting increased unemployment and decisions, in Ireland, to bail out failed banks).
- Although euro-area government debt (88% of GDP) and budget deficits (4.1% of GDP) are lower in aggregate as a percentage of GDP than the US and Japan, the debt and deficits of some individual governments in the euro area are much higher than the average. The market looks at each individual government because, under the EU Treaty, governments in the euro area do not stand behind each other's debts.
- The average maturity of the government debt in most countries in the euro area is significantly shorter than (say) the UK. So even if budget deficits are reduced, the amount of debt to be refinanced is still large (eg the Italian Government needs to raise over €200 billion through bond issuance in 2012). In addition, a substantial proportion of outstanding debt is held by international investors (eg 50% in the

case of Italy). Debt is likely to be less firmly held by international investors than by domestic investors.

- Government debt in the euro area is different from government debt denominated in the domestic currency of other countries (eg the US, UK, Switzerland and Japan), because individual governments in the euro area cannot themselves ensure that money is printed to repay it. The ECB does not act as lender of last resort to governments in the euro area and is prohibited under the EU Treaty from buying primary issues of government debt.
- There have been increasing concerns in the market (at least since the Deauville Summit between France and Germany in October 2010) that government debt in the euro area is not risk-free, not just in the case of Greece, but in the case of some other governments as well.
- Euro-area governments, which previously argued that their commitment to the euro was irrevocable, have on a number of recent occasions acknowledged the possibility of euro exit (whether voluntary or compulsory). This is not provided for in the existing Treaty, and had previously not been regarded in the market as a risk. In response, the market may have begun to price in this risk.
- The sovereign problem and the bank problem are related, because banks in the euro area have substantial holdings of sovereign debt (eg to meet their liquidity needs). The increase in yield on sovereign debt, which reduces its price, has led to losses on bank balance sheets, which have already been weakened by the crisis.
- Contagion has spread the crisis among the banks and governments from the periphery of the euro area towards the core. It also risks fragmenting the single capital market in Europe by driving banks to match their assets and liabilities within each country in which they operate rather than across borders.
- These factors, taken together, are having a substantially adverse impact on the economic outlook for growth in the euro area, on the surrounding economies in Europe (such as the UK) and more widely. Quite apart from the general importance of growth in political and economic terms, the resumption of growth is of specific importance in making debt service sustainable in the medium term.



So far, the focus appears to have been more on preventing the next crisis rather than resolving the current one.

Resolving the problem: sovereign debt

The policy response to the sovereign debt problem in the euro area requires both *adjustment* – to reduce the fiscal deficit in debtor countries – and *financing* – to finance the remaining fiscal deficit and the maturing debt. So far, there has been a lack of confidence in the market about the steps which the euro-area authorities have taken to address the sovereign debt problem in both of these areas, and about the delays in implementing decisions previously made. In so far as decisions have been made, the focus appears to have been more on preventing the next crisis rather than resolving the current one.

Adjustment

The five euro-area countries most seriously affected by the crisis – Greece, Ireland, Portugal, Spain and Italy – have all sought to reduce their budget deficits and make structural changes to improve the prospects for growth in the longer term. In some cases (Greece (twice), Ireland and Portugal), the EU and the IMF have agreed to provide “bail-outs” to the governments concerned, provided that they take adequate austerity measures. In others (Italy and Spain), the governments have taken austerity measures which are designed to avoid bail-outs. In all these cases, the austerity measures taken have been accompanied by changes of government: either following elections (in Ireland, Portugal and Spain), or technocratic governments have taken over without elections though with parliamentary support (in Greece and Italy). But adjustment takes time; prospects for growth are reduced in the short term; and budget deficits tend to increase before they decline. So far, there have been no compensating adjustments in creditor countries: in other words, while debtor governments have agreed to cut their deficits, creditor governments have not agreed to increase their own deficits to compensate.

The austerity measures taken by individual debtor governments have now been supplemented by proposals – from Germany and France – for a Fiscal Compact involving all euro-area governments, which were agreed at the EU Summit on 9 December 2011. The Fiscal Compact will require in each euro-area country: national constitutional limits on structural deficits which should not exceed 0.5% of GDP; automatic sanctions if the government deficit exceeds 3% of GDP, unless a qualified majority of euro-area Member States opposes this; if government debt exceeds 60% of GDP, the debt needs to be reduced at an average rate of one-twentieth per annum; national budgets need to be approved in advance by the European Commission; and national debt issuance needs to be reported in advance.

These measures do not represent a full fiscal union, involving central control over expenditure and taxation and transfers from richer countries to poorer countries. Instead, they represent a strengthened form of the Stability and Growth Pact in which each government is responsible for achieving budget balance (ie without transfers between them). The market will need to be convinced that the SGP will work this time when it did not work last time. There is a separate question about how to address the “democratic deficit” implied by the introduction of a Fiscal Compact at euro-area level.

The Fiscal Compact will take time to implement. One possible way of implementing it would have been to make the necessary changes in the EU Treaty. But this would have involved agreement by all 27 EU Member States. At the EU Summit on 9 December 2011, the UK vetoed a change in the Treaty. So the 17 members of the euro area and the other non euro-area members in the EU are now exploring alternative ways to proceed (ie “as 26”), with the objective of reaching an international agreement which is due to be signed by March 2012 at the latest.

Financing

Ideally, the market would wait for fiscal adjustment to work so as to reduce the need for financing, but governments cannot assume that the market is willing to finance deficits and maturing debt in the meantime. So the next question is what other options are available for financing, if access to the market is restricted or closed off entirely in some countries. There are two related issues to address, neither of which is straightforward:

First, *private sector involvement*: In the case of Greece, private sector bondholders were initially invited (in July) “voluntarily” to take a 21% “haircut”. This was subsequently increased (in October) to 50%. (The ECB, which also holds Greek sovereign debt as a result of purchasing it in the secondary market, is not expected to be included in this arrangement.)

It is the realisation that sovereign debt is not risk-free in the case of Greece that has led market participants to question whether it is necessarily risk-free in some other countries. So the problem for the euro-area authorities has become how to ring-fence other euro-area sovereigns against the risk of contagion from Greece. One response has been for the authorities to argue that Greece is “unique and exceptional”, and by implication that private sector involvement will not be required elsewhere (though collective action clauses are still to be included in the terms and conditions of all new euro-area government bonds). But that may not be sufficient without additional financial measures to back it up: ie the creation of a “firewall”.

The creation of a “firewall” is the second issue. The European Financial Stability Facility (EFSF), which was originally designed for this purpose, is too small (€440 billion, of which €250 billion has not yet been committed) to bail out a large euro-area sovereign. So negotiations have been going on for some time about how best to leverage the EFSF.

- One approach originally considered was to turn the EFSF into a bank. But the ECB was not willing to finance it. If instead the EFSF had had to rely on the market for financing, there would have been a risk of a knock-on effect on the ratings of the triple A governments which back it. (The cost of the EFSF’s own financing rose significantly above bonds during the fourth quarter.)
- Another approach would be to turn the EFSF into a guarantor or “first loss” insurer (covering (say) 20% of Italian or Spanish Government debt). This would avoid the need to put cash up front. But it would create two-tier markets (eg between (say) Italian debt which is insured and French debt which is not; and new issues, which are insured, and old issues which are not); and the EFSF would still be vulnerable to ratings downgrades.
- A third approach – adopted at the EU Summit on 9 December 2011 – is to bring forward the date of implementation of the Treaty on the European Stability Mechanism (ESM) from July 2013 to July 2012; and, instead of using the ESM to replace the EFSF, as originally envisaged, to keep the EFSF in place until mid-2013. The overall EFSF/ESM ceiling of €500 billion is due to be reassessed in March 2012, though it is not clear at this stage whether the German Government will agree to raise it.
- A fourth approach is to seek co-financing from governments and central banks outside the euro area. But they have been reluctant to make commitments when euro-area governments themselves appear unwilling to do so. As a result, most (but not all) governments in the EU have decided to lend €150 billion to the IMF in the form of bilateral loans so that the IMF has adequate resources to deal with the crisis, including lending back to euro-area debtors, while shielding creditors from the underlying credit risk.

Whatever scheme is used, the key questions are whether it is credible in the market (particularly if there is a risk of triple A sovereign rating downgrades), and whether parliamentary approval is needed (eg in Germany) and can be obtained quickly.



The market will need to be convinced that the SGP will work this time when it did not work last time.



The ECB is willing to lend in unlimited amounts to the euro-area banking system against eligible collateral.

The most credible euro-area institution in the market is the ECB. Unlike the central banks in many other parts of the world, the ECB is not allowed under the EU Treaty to buy government debt in the primary market, and the German authorities consider that buying government debt in unlimited amounts in the secondary market still constitutes monetary financing. So the ECB has so far only been willing to buy government debt in the secondary market – and offset the monetary effects – in comparatively small amounts on its own account, though it has also agreed to act as agent on behalf of the EFSF in its market operations.

One of the problems has been that the ECB does not want to create “moral hazard” by removing the incentive for governments whose debt it buys to persist with their adjustment programmes. The ECB also wants to ensure that its own credibility in the market is not damaged.

However, the ECB is willing to lend in unlimited

amounts to the euro-area banking system against eligible collateral. Using this financing, euro-area banks could in theory themselves buy new issues of euro-area government debt, and deposit them as collateral with the ECB. Once the primary deficit was financed, secondary market intervention by the ECB in limited amounts should then be more effective. Instead of a vicious circle of default risk and exit (ie currency) risk, that might help create a virtuous circle and give time for adjustment to work. But all this would depend on whether banks were willing to accept the sovereign credit risk involved, rather than using the proceeds from the ECB to repay other maturing bank debt.

A separate proposal from the European Commission would be to issue Stability Bonds (ie “eurobonds”), backed by the joint and several – or at least the several – guarantees of all euro-area governments. Eurobonds would improve access and reduce funding costs for debtor governments and increase them for creditor governments (unless a transfer mechanism is introduced). Creditor governments are also concerned about the risk that, if debtor governments can borrow easily and cheaply, there is less incentive for them to adjust by reducing their budget deficits (ie moral

hazard). Eurobonds appear to have been ruled out for the time being, on the grounds that the Fiscal Compact needs to work first; but they may still be reconsidered at a later stage if suitable changes in the Treaty can be agreed.

Resolving the problem: the banks

Apart from resolving the sovereign debt problem, a related problem that also needs to be resolved is how to ensure that the banks have sufficient *capital* to withstand losses on their holdings of sovereign bonds, and that they have continued access to sufficient *liquidity* if they are not able to borrow in the market.

Capital

How much extra capital is going to be needed by the banks in aggregate to ensure continued solvency? The European Banking Authority (EBA) has proposed a 9% level of Core Tier 1 capital by the end of June. Following another set of stress tests, which acknowledge the possibility of sovereign losses, the EBA considers that this would mean a €115 billion recapitalisation in aggregate this time. That is much more than proposed last time, but still significantly less than original market expectations.

The next question is how the recapitalisation is going to be financed. Some banks may not be able to raise capital in the market themselves, or prefer not to do so as the market value of their share price is at a significant discount to book value. They may also be reluctant to accept the stigma of government or EFSF support, if this were to become public. So banks may prefer to meet higher capital requirements by deleveraging, allowing maturing loans to roll off and reducing new lending, rather than by raising new capital (or selling assets at depressed prices). That would create a dilemma for governments, as it could delay the economic recovery.

Liquidity

Banks in the euro area which have been shut out of the market for liquidity have increasingly had to rely on borrowing from the ECB. The ECB has taken three steps to ease liquidity over the past quarter:

- First of all, the ECB has eased monetary conditions in the euro area by twice reducing short-term



Banks may prefer to meet higher capital requirements by deleveraging.

euro interest rates by ¼%, reversing increases earlier in 2011. It has also reduced bank reserve requirements from 2% to 1%.

- Second, the ECB has recently decided to extend the liquidity it provides to the banking system through term loans of up to three years against eligible collateral, which is now defined more broadly. (The ECB lent €489 billion gross to the banks for three years on 21 December 2011, of which around €200 billion represented net new lending.) If this liquidity helps to restore confidence, banks may be willing to use part of the proceeds of their borrowings from the ECB to invest in their own government's debt at a higher yield, contributing to financing the deficit and bringing down yields, with the result that losses are reduced. Alternatively, the proceeds may be used to reduce the banks' own financing needs. One related question that needs to be addressed is to what extent sovereign debt will be treated as risk-free for regulatory and accounting purposes.
- Third, central banks outside the euro area have also agreed to reduce the shortage of US dollar funding available to some euro-area banks (eg as a result of withdrawals by US money market funds) by providing US dollar liquidity over the year-end and by reducing the interest rate at which it is provided.

In addition, banks in the EU have substantial future refinancing requirements, with estimates of around €700 billion in outstanding debt (excluding short-term debt) falling due for repayment in 2012. Some of this debt was originally issued earlier in the crisis with the help of government guarantees, which have now been withdrawn. There is a question about whether guarantees will again be needed, on the one side, and whether governments can afford to provide them,

on the other. The three-year loans from the ECB may represent an alternative source of refinancing for maturing bank debt.

Improving competitiveness

In the longer term, the external competitiveness of debtor countries in the euro area can only be restored if there is a downward adjustment in their relative costs. If the exchange rate of the euro does not depreciate against third country currencies (eg the US dollar) and the costs in euro-area creditor countries do not increase in relative terms, the question becomes one for the debtor countries themselves: in particular whether *internal* devaluation (ie cuts in wages and pensions, higher taxes or reduced debt payments as a result of debt restructuring) is sufficient to regain competitiveness without *external* devaluation.

In a monetary union, external devaluation is not possible without leaving it. And there are no provisions for exit from the euro area in the EU Treaty (though EU members can negotiate withdrawal from the EU). But there have recently been a number of references by the authorities in the euro area to the possibility of euro exit; and, if a Greek referendum had gone ahead, it would in practice have been interpreted as a referendum about whether Greece should be "in" or "out". So discussion of euro exit is no longer taboo. As a result, the market may already have begun to price in this risk: the rise in sovereign bond yields, not just on the periphery of the euro area, but nearer to the core, may reflect the market's view not just about the risk of default, but about currency risk, though clearly there are also other factors at work.

The UK authorities have recently suggested that it would be prudent for market firms to make contingency plans for euro exit, however unlikely this might be. If euro exit were to happen, there is a risk that it might happen suddenly, whether by choice or expulsion; exit would not necessarily wait for the legal negotiations on withdrawal to be completed first, given political and economic pressures. The withdrawing country might face a run on its banks (abroad or into banknotes). Capital controls might need to be imposed (even though this would not be consistent with the Single Market). Local banks might also need to be recapitalised, presumably by the government, as no other investors could be counted on to do so.



In a monetary union, external devaluation is not possible without leaving it.

There would also of course be very important legal implications. These may be – but have not so far been – set out in an international agreement. The key question is how existing financial contracts would be treated. Such an analysis might be different if one country were to leave the euro area on its own from what would happen if there were to be a complete break-up of the euro area.

- If one country were to leave on its own, euro contracts under domestic law (eg domestic bank accounts) would presumably be redenominated in the successor national currency. Contracts under foreign (eg English) law might remain denominated in euro. But this would not be known until it was tested. In the case of a bond issue, an international law firm has suggested that there might be a number of factors to take into account: not just the governing law of the issue, but also whether there is submission to the exclusive jurisdiction of foreign (eg the English) courts; the way in which the obligations to pay in a particular currency are drafted; and the place of payment set out in the terms of conditions.
- If there were to be a complete break-up of the euro area, then it would be even more difficult to know what the successor currency to be used in payment should be (eg in the case of contracts denominated in euro between counterparties in London and written under English law).
- One of the important issues to be considered in any contingency planning is whether, and to what extent, it might be possible to “euro proof” financial contracts in advance; and whether any additional risk disclosures should be made in prospectuses, and if so what these should say, bearing in mind that euro exit is only one among a number of risks arising from the international financial crisis.

Whether euro exit would lead to an improvement in the external competitiveness of the country concerned would depend on the outcome to all these questions, and the subsequent policy response by its government and the other countries affected.

Other capital market issues

Finally, the euro crisis is also affecting the international capital market in Europe in a number of other ways:

- *Single Market:* The proposed Fiscal Compact, which brings together the 17 euro-area “ins”, may increase the division within the Single Market between the “ins” and the 10 euro-area “outs”, and between “outs” that want to join the euro area and others that do not, including the UK, whose Government has said that it will never join. Will there be a level playing field within the Single Market in future, if all the “ins” work together to obtain a qualified majority to introduce new Single Market measures despite opposition among the “outs”?
- *Corporate bonds:* Some highly rated corporate issuers are now able to obtain funding from investors on better terms than their own banks. This may lead to increased disintermediation from the banking system.
- *Market making:* Proposals (eg in MiFID II and MiFIR) for new regulatory constraints on secondary market trading may discourage any recovery in market making.
- *Collateral:* The shortage of collateral in the financial system has become a pressing issue, as more bank financing has had to be undertaken on a secured basis, both short term and longer term (eg via covered bonds), leaving a smaller proportion of bank balance sheets unencumbered for unsecured creditors; a number of banks have become more dependent on the ECB, which only provides finance on a secured basis, leaving less collateral available for secured private sector lending; and the value of collateral has had to be written down, as haircuts have increased. This problem will increase in future as banks have to hold higher liquidity buffers (tying up financial assets which cannot be pledged as collateral), and more collateral must be set against central counterparty and bilateral counterparty credit exposures. Some sovereigns are also being pressed to provide collateral to their counterparties.



The shortage of collateral in the financial system has become a pressing issue.

- *Credit default swaps (CDS)*: There is a question about whether the CDS market will be damaged if a 50% haircut (proposed to private sector bondholders in the Greek case) does not trigger a credit event on the grounds that the refinancing is “voluntary”. The euro-area authorities have been keen to avoid a credit event. If a credit event is not to be triggered, then banks and other users of CDS may be more reluctant to pay for them in future and, if they cannot hedge their bond positions, they may simply sell their bonds.
- *Credit rating agencies (CRAs)*: CRAs have come under increasing scrutiny from the authorities on the grounds that rating downgrades have a damaging pro-cyclical effect, whereas CRAs argue that they simply provide information, which is a necessary role: ie the equivalent of a thermometer reading for the patient.
- *Financial Transactions Tax (FTT)*: The French and German Governments have proposed an FTT to raise money from the banks to help pay for bail-outs: but if implemented, the costs would be passed on by the banks to end-users, and there is a risk that banks might relocate to jurisdictions where the FTT did not apply, with damaging effects on growth. An FTT would have a particularly severe impact on short-term financing, such as repos and commercial paper, given the proposed flat rate charging system for each transaction.

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In brief



The key condition for restoring confidence in the international capital market in Europe remains the resolution of the sovereign debt and banking crisis in the euro area. The policy response to the sovereign debt problem requires both *adjustment* – to reduce the fiscal deficit in debtor countries – and *financing* – to finance the remaining fiscal deficit and the maturing debt. A related problem is how to ensure that the banks have sufficient *capital* to withstand losses on their holdings of sovereign bonds, and continued

access to sufficient *liquidity* if they are not able to borrow in the market. In the longer term, the external competitiveness of debtor countries in the euro area can only be restored if there is a downward adjustment in their relative costs. In the meantime, the euro crisis is also affecting the international capital market in a number of other ways.

Recent practical initiatives by ICMA

Sovereign bond markets

1. ICMA has made a significant contribution to the work of the EU Sovereign Debt Markets Group to formulate collective action clauses (CACs) in euro-area sovereign securities.
2. ICMA has submitted a short response on technical aspects of the European Commission's Green Paper on the *Feasibility of Introducing Stability Bonds*. The response draws particular attention to the views of ICMA's Asset Management and Investors Council (AMIC).
3. Working with Clifford Chance, ICMA has held a members' teleconference on the implications of the euro crisis for bond documentation. ICMA has also created a new website page on the potential implications of a change in euro-area composition.
4. With ISDA and AFME, ICMA has published a short paper, *The Impact of Derivative Collateral Policies of European Sovereigns and Resulting Basel III Capital Issues*. The associations recommend that careful consideration be given to the adoption of two-way collateral agreements by European sovereigns, which would ameliorate all of the issues discussed in the paper.
5. ICMA plans to launch early in 2012 a new Public Sector Issuer Forum for the sovereign, supranational and agency sector.

Short-term markets

6. Key members of ICMA's European Repo Committee (ERC Committee) have engaged with the Financial Stability Board's (FSB's) working group on the regulation of securities lending/repo activities, which has been formed as one part of the FSB's *Shadow Banking* project.
7. With the participation of ICMA members conducting repo business in Europe, the 22nd ICMA ERC European Repo Survey took place as of 7 December 2011. Results should be published in January.
8. The ICMA ERC Committee and the ERC Operations Group have held meetings with Monte Titoli to follow up earlier correspondence regarding concerns prompted by system outages.

Primary markets

9. Following publication of an explanatory note on *New Issue Processes*, ICMA is considering further guidance or recommendations, taking into account the legal constraints imposed by the Market Abuse Directive and MiFID.
10. ICMA has responded to an ESMA consultation on a second instalment of delegated acts under the revised Prospectus Directive.
11. The Joint Associations Committee (JAC) on retail structured products, of which ICMA is a member, has submitted a response to the European Commission on ESMA's formal advice on a first instalment of delegated acts under the revised Prospectus Directive.
12. ICMA has filed, with the US Department of the Treasury and Internal Revenue Service, a request for clarification on the US Foreign Account Tax Compliance Act (FATCA).
13. ICMA has supported the translation into French and German of the JAC combined principles on issuer/distributor and distributor/investor relationships.

Secondary markets

14. ICMA has alerted members to the implications of the EU's market reform programme in MiFID II and MiFIR.
15. ICMA has been working with other trade associations, wherever possible, to address concerns about conditions in the secondary cash and repo markets.
16. The ICMA Legal Helpdesk has been heavily used, with many questions about the buy-in rules, interest claims, the calculation of accrued interest and other matters arising from ICMA's Secondary Market Rules and Recommendations.

Asset management

17. A new organisational structure has been agreed by the AMIC to meet the needs of current and prospective AMIC members to remain independent from the representation of the sell side of the industry, as well as being transparent and efficient.

18. The ICMA Covered Bond Investor Council has published feedback and comments on responses received as part of its consultation on European transparency standards.
19. The AMIC has responded to the Kay review of *UK Equity Markets and Long-Term Decision-Making*.
20. In response to a request from asset management members, ICMA has established a working group within the AMIC on the impact of Solvency II on services delivered by asset managers to their clients.

Market infrastructure

21. Given the emphasis in the market on secured lending, there is increasing concern about the scarcity of collateral at a time when the demand for it is rising as a result of regulatory change. ICMA expects this to be a key issue for members over the next 12 months and is leading work with other associations to form a Collateral Initiatives Coordination Forum.
22. The International Council of Securities Associations (ICSA), of which ICMA is a member, has written to regulators supporting the development of a global legal entity identification (LEI) system which would enable the accurate and unambiguous identification of entities engaged in legal transactions.

Other engagement with regulators

23. ICMA has contributed to a letter which ICSA has sent to the European Commission expressing the securities industry's opposition to the proposed EU Financial Transactions Tax.
24. With its members, ICMA has also over the past quarter held meetings with senior representatives of the ECB, ESMA, the European Commission, the Bank of England and a number of national regulators.

Regulatory Response to the Crisis



by David Hiscock

G20 financial regulatory reforms

Coordinated by the International Federation of Accountants, the Private Sector Taskforce (PSTF) includes: CFA Institute (CFA I); INSOL International; Institute of International Finance (IIF); International Accounting Standards Board (IASB); International Actuarial Association (IAA); International Corporate Governance Network (ICGN); International Insurance Society (IIS); and International Valuation Standards Council (IVSC).

The PSTF was established in May 2011 at the request of the Presidency of the G20. Released on 6 October 2011, the [PSTF Report to G20 Deputies](#) provides the G20 with an analysis of the development of financial policy and regulation, with the aim of facilitating economic stability in the world's capital markets. The benefits of regulatory convergence are identified, as well as the inefficiencies and associated costs created by regulatory gaps. A range of possible scenarios and associated risks are thoroughly analysed and explored, specific examples are given, and a set of 15 recommendations are provided.

The [15 October 2011 Communiqué](#) of Finance Ministers and Central Bank Governors of the G20 following from their meeting in Paris covers a variety of points regarding ongoing efforts to address economic problems and develop a more robust financial system. With respect to aspects of ongoing financial regulatory reform, point 4 of the Communiqué is particularly pertinent.

On 18 October 2011, the FSB [announced](#) the publication of [A Coordination Framework for Monitoring the Implementation of Agreed G20/FSB Financial Reforms](#). The implementation process is increasingly the focus of public and financial industry attention, and FSB member jurisdictions have committed to lead by example. The FSB is responsible for coordinating and promoting the monitoring of the implementation of agreed G20 and FSB financial reforms; and for reporting on this to the G20. To strengthen the coordination and effectiveness of its monitoring, the FSB, in collaboration with standard-setting bodies, has established this framework. The FSB Standing Committee on Standards Implementation (SCSI) will play a coordinating role within the FSB in monitoring implementation efforts.



G20 Leaders endorsed the implementation of an integrated set of policy measures from the FSB for addressing the risks associated with SIFIs.

The Framework also highlights priority areas where consistent and comprehensive implementation of reforms, as determined by the G20, is most critical for global financial stability. These areas will undergo more intensive monitoring and detailed reporting, including on implementation progress on a country-by-country basis. The initial priority areas for monitoring are the Basel III framework; over-the-counter (OTC) derivatives market reforms; compensation practices; policy measures for global systemically important financial institutions (G-SIFIs); resolution frameworks; and shadow banking. The priority areas will be updated annually in light of international policy developments, with progress in each area being reported on at least once a year.

On 27 October 2011, the FSB announced the publication of its report on *Recommendations to Strengthen Oversight and Regulation of Shadow Banking*. The FSB issued a [background note](#) in April to invite views from the public and a [press release](#) in September on progress and next steps. The report, which has been prepared by an FSB task force and reflects comments received on the background note, now sets out practical recommendations in more detail. The report has been informed by a detailed monitoring exercise by the task force during summer 2011 to review recent trends and developments in the global shadow banking system, as well as a thorough regulatory mapping exercise to take stock of existing national and international initiatives.

The report's recommendations for effective monitoring set out high-level principles for the relevant authorities and a stylised monitoring process. The report's recommendations to strengthen regulation set out general principles for designing and implementing regulatory measures to address the risks identified by the monitoring process. The report also describes work plans for the five

workstreams, which were announced in September, that will assess in more detail the case for further regulatory action. All five workstreams will report their proposed policy recommendations to the FSB, which will continue to review the workstreams so as to provide consistency to the overall project. Specific ICMA interest in these workstreams is further discussed in the short-term markets section of this Quarterly Report.

On 3-4 November 2011, there was a G20 leaders' Summit meeting in Cannes. The [Summit Communiqué](#) reaffirms commitment to work together and reports decisions taken to reinvigorate economic growth, create jobs, ensure financial stability, promote social inclusion and make globalisation serve the needs of the people. Of particular note in relation to financial regulation, there is a section of this headed *Reforming the Financial Sector and Enhancing Market Integrity*. In summary, the points made are:

- affirmation that the G20 will implement its prior commitments and pursue the reform of the financial system;
- agreement on comprehensive measures so that no financial firm can be deemed "too big to fail", noting the FSB's newly published list of G-SIFIs;
- decisions to develop the regulation and oversight of shadow banking; develop further regulation on market integrity and efficiency (addressing risks

posed by high frequency trading and dark liquidity); task IOSCO to assess the functioning of CDS markets; and agreement on principles to protect financial services consumers;

- financial sector behaviour to change, with strict implementation monitoring of commitments regarding banks, OTC markets and compensation practices; and
- agreed reform of the FSB to improve its capacity to coordinate and monitor the G20's financial regulation agenda; also noting the departure of Mario Draghi from the Chair of the FSB and the [appointment of Mark Carney](#), Governor of the Central Bank of Canada, as the new FSB Chair.

There is also a lengthier [Cannes Summit Final Declaration](#), in which *Implementing and Deepening Financial Sector Reforms* is covered by paragraphs 22-39. As from 1 December 2011, the G20 Chair passes from France to Mexico, which will host the next scheduled G20 Leaders' Summit set to be held in Los Cabos, Baja California, in June.

The FSB published a statement providing [Information on the Jurisdictions Evaluated](#) to date under its initiative to encourage the adherence of all countries and jurisdictions to regulatory and supervisory standards on international cooperation and information exchange. The 61 jurisdictions evaluated by the

FSB were selected on the basis of their financial importance – 41 of these already demonstrate sufficiently strong adherence to the relevant standards and 18 others are implementing reforms to strengthen their adherence, or seeking assessments (only Libya (former regime) and Venezuela have not engaged in dialogue).

The [Chairman of the FSB reported](#) to the G20 Leaders at the Cannes Summit on progress in the implementation of the G20 recommendations on financial regulatory reforms. Prior to the meeting the Chair [set out in a letter](#) a number of issues in this regard. In connection with this, the FSB also published:

- an [overview report on progress](#) in the implementation of the G20 recommendations for strengthening financial stability; and
- a “[scoreboard](#)” [status report](#) prepared by the FSB Secretariat, in consultation with FSB members, that assesses the status of progress made in global policy development and implementation of financial regulatory reforms.

At the Summit, the G20 Leaders endorsed the implementation of an integrated [set of policy measures](#) from the FSB for [addressing the risks associated with SIFIs](#) and the timeline for implementation of these measures. Specific measures focus on G-SIFIs, to reflect the greater risks that these institutions pose to the global financial system; and the FSB published the names of an initial group of 29 G-SIFIs (as an annex), which will be updated annually. The policy measures announced comprise:

- a [new international standard](#) as a point of reference for reforms of national resolution regimes, to strengthen authorities’ powers to resolve failing financial firms in an orderly manner and without exposing the taxpayer to the risk of loss;

- requirements for resolvability assessments, recovery and resolution plans and institution-specific cross-border cooperation agreements for G-SIFIs;
- [requirements for G-SIBs](#) to have additional loss absorption capacity above the Basel III minimum; and
- [more intensive and effective supervision](#) through stronger supervisory mandates, and higher supervisory expectations for risk management functions, risk data aggregation capabilities, risk governance and internal controls.

The additional loss absorbency requirement will apply from 2016, initially to those banks identified in November 2014 as G-SIFIs. These banks will also have to meet the higher supervisory expectations for data aggregation capabilities by January 2016.

IMF Managing Director, Christine Lagarde, [issued a statement](#) following from the G20 Cannes Summit. Inter alia this notes the support given by the G20 leaders to strengthening the role of the IMF. The IMF published a staff report entitled [From Pittsburgh to Cannes: IMF Umbrella Report – G-20 Mutual Assessment Process \(MAP\)](#). This provides an integrated summary of the analysis and assessment in IMF staff’s component reports for the G20 MAP – toward informing a desirable action plan.

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Macprudential regulation

On 3 October 2011, the minutes of the [20 September 2011 meeting](#) of the UK’s Interim Financial Policy Committee (FPC) were published. Within the section on *Macprudential Instruments* the developing thinking on how regulation

may be used to allow the FPC to meet its objectives is described. In particular the FPC judged that, alongside its broader scope to make recommendations, it would need to have directive powers over three broad categories of policy tool affecting: (i) the balance sheets of financial institutions (including non-banks); (ii) the terms and conditions of transactions in particular financial markets; and (iii) market structures.

The FPC went on to review a number of potential tools within each category. In the latter category it considered that targeted disclosure requirements might help to limit the risk that uncertainty about specific exposures or interconnections might amplify disturbances. Also variations in risk weights on intra-financial system activities might lean against excessive exposures of institutions within the financial system. Finally, the FPC noted that the resilience of markets that were central to the smooth functioning of the system as a whole could be strengthened by obligations to conduct financial trading on organised trading platforms and/or to clear trades through central counterparties.

In addition, the FPC was concerned that its ability to achieve its proposed statutory objective by varying regulatory requirements at a national level could be constrained by current proposals by the European Commission to implement Basel III and other regulatory rules in Europe through “maximum-harmonising” regulations.

Then, on 20 December 2011, the Bank of England [issued a News Release](#) entitled *Instruments of Macprudential Policy – Discussion Paper*. This reviews the FPC’s three broad categories of policy tool, as discussed above, and the specific policy tools in each category. The FPC is seeking feedback on this interim analysis by 10 February.



National macroprudential authorities of EU Member States must be able to tighten settings of prudential instruments to levels above those provided for in EU legislation.

On 11 October 2011, Jean-Claude Trichet appeared before ECON in his capacity as Chair of the ESRB. His [introductory comments](#) started with some comments on the current situation, including an ESRB call for immediate action. Moving on, he discussed that the ESRB has published its first recommendation, [On Lending in Foreign Currencies](#) – which is a phenomenon that entails significant risks for the financial sector. The ESRB is also working on systemic risks that could originate from banks' funding in foreign currencies.

Next, he highlighted the ESRB's views on the macroprudential implications of EU legislation, stressing that national macroprudential authorities of EU Member States must be able to tighten settings of prudential instruments to levels above those provided for in EU legislation in a timely fashion and based on local economic conditions. Finally, he described the ESRB's ongoing work on structural, medium-term issues; and reported that the ESRB has responded to two public consultations initiated by ESMA – firstly on UCITS, ETFs and structured UCITS, and secondly on high-frequency trading.

On 22 December 2011, the General Board of the ESRB held its fourth regular meeting. In the [introductory statement](#) to the press conference after the meeting there are some comments on the ESRB's view of the current situation and regarding how it sees things looking ahead. There is then some commentary on work that is continuing within the ESRB on risks that may be threatening the resilience of the financial system either individually or collectively and on developing macroprudential policy and instruments in the EU. This includes a particular note that the ESRB will assess recourse to certain types of securitised funding and its impact in terms of the encumbrance of assets and the stability of innovative funding sources.

On 27 October 2011, [the FSB, IMF and BIS issued](#) a progress report to the G20 on macroprudential policy tools and frameworks. This traces progress in implementing macroprudential policy frameworks along three broad lines:

- advances in the identification and monitoring of systemic financial risk;
- the designation and calibration of instruments for macroprudential purposes; and
- building institutional and governance arrangements in the domestic and regional context.

The report's main message is that effective macroprudential frameworks require institutional arrangements and governance structures that, tailored to national circumstances, are able to mobilise the right tools to limit systemic risk as well as ensure a frank dialogue and resolve conflicts among policy makers' objectives. The report also highlights the scope for further progress in the identification of systemic risk, the collection and analysis of data, in assessing the performance of newly introduced tools and in the establishment of institutional arrangements for the conduct of policy.

The BIS and the Bank of Korea jointly organised a conference on macroprudential regulation and policy in Seoul, Korea, on 16-18 January 2011. The conference aimed to bring academics together with researchers at central banks and other public institutions to present and discuss ongoing theoretical and empirical work in the field. Governor Choongsoo Kim of the Bank of Korea gave the welcome address, and Governor Stefan Ingves of Sveriges Riksbank and Professor Hyun Song Shin from Princeton University gave keynote speeches. The conference concluded with a policy panel focusing on macroprudential policy frameworks. On 16 December 2011, the BIS made available a [collected volume](#), containing the welcome address, keynote speeches, revised versions of all 12 papers presented during the conference and the panel discussions.

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OTC (derivatives) regulatory developments

As announced in its [11 October 2011 press release](#), the FSB published its [second six-monthly progress report](#) on implementation of OTC derivatives market reforms. The report provides a detailed review of progress toward meeting the commitment of G20 Leaders at the Pittsburgh 2009 Summit that, by end-2012, all standardised OTC derivative contracts be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties; that OTC derivative contracts be reported to trade repositories; and that non-centrally cleared contracts be subject to higher capital requirements.

The report notes that, as of now, few FSB members have the legislation or regulations in place to provide the framework for operationalising the commitments. While recognising the implementation challenges and the complexity of the needed laws and regulations, the report concludes that jurisdictions should aggressively push forward to meet the G20 end-2012 deadline in as many reform areas as possible.

As a key element of its work going forward, the FSB's OTC Derivatives Working Group will continue actively to monitor the consistency of implementation across jurisdictions and bring to the attention of the FSB any overlaps, gaps or conflicts that may prove detrimental to G20 reform objectives, particularly if there seems to be a risk that they will not be satisfactorily resolved through existing bilateral or multilateral channels. The FSB will publish a further progress report in the spring.

The [OTC Derivatives Regulators' Forum](#) (ODRF) is a group of over 50 financial authorities – including central banks, markets authorities and prudential

supervisors – which meet periodically to exchange views and share information on OTC derivatives central counterparties (CCPs) and trade repositories. [The ODRF met](#) on 4-5 October 2011 in New York and discussed its ongoing work in the context of OTC derivatives reform being put into place in different jurisdictions. Topics of discussion during the meeting included the ODRF's work with a number of OTC derivatives trade repositories with respect to their functionality and the needs of the global regulatory community, and the development of cooperative oversight arrangements among authorities involving OTC derivatives CCPs and trade repositories with wide international memberships. The ODRF also discussed its future priorities, including its engagement with international standard-setting bodies. The next in-person meeting of the ODRF will be held in Hong Kong in March.

On 8 December 2011, leaders and senior representatives of the authorities responsible for the regulation of the OTC derivatives markets in Canada, the European Union, Hong Kong, Japan, Singapore and the United States met in Paris. Since mid-2011, the authorities have engaged in a series of bilateral technical dialogues on OTC derivatives regulation. This meeting, [held at ESMA headquarters](#), is the first time the authorities have met as a group to discuss their implementation efforts. In the meeting, the authorities addressed the cross-border issues related to the implementation of new legislation and rules to govern the OTC derivatives markets in their respective jurisdictions. At the conclusion of the meeting, the authorities agreed to continue bilateral regulatory dialogues and to meet as a group again in early 2012.

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There could be significant market impact if ahead of the end of April deadline there will be no clarity about the likely endorsability status.

Credit rating agencies

On 31 October 2011, ESMA [announced the successful registrations](#) of DBRS, Fitch Ratings, Moody's Investors Service and Standard & Poor's (S&P) as credit rating agencies (CRAs), compliant with the requirements of the EU Regulation on CRAs. These registrations are valid for all European entities of DBRS, Fitch, Moody's and S&P respectively (a list of the 17 entities concerned is given in table 1, annexed to the announcement). The announcement then provides an update on endorsement of third countries' ratings. At this moment, ESMA notified market participants that only the regulatory framework applicable to CRAs in Japan has been recognised to be in line with the requirements of the EU Regulation on CRAs (see table 2 annexed to the announcement), while several other third countries are in advanced state of aligning their regulatory framework to the requirements of the EU Regulation on CRAs. Given the ongoing recognition process of other third countries, a transitional period of three months (until 31 January) was granted.

On 22 December 2011, [ESMA then announced](#) that it has decided to extend until 30 April the initial transitional period of three months for credit ratings issued outside the EU. This decision allows the use in the EU of credit ratings issued in third countries while

the convergence process with the EU requirements and the endorsement process of third countries continue.

At the same time, following a careful assessment of its regulatory framework, ESMA announced that it has decided to endorse Australia's regulatory regime on credit ratings according to Art. 4(3) of the EU CRA Regulation; and has concluded the exchange of letters establishing the required co-operation arrangement. Together with Japan, this means that two third country endorsement decisions are now in place.

ESMA is also in an advanced state of its assessment for several other non-EU countries, namely Argentina, Canada, Hong Kong, Singapore, and the US; and ESMA is also currently examining the regulatory frameworks of Brazil and Mexico. ESMA is conscious that there could be significant market impact if ahead of the end of April deadline there will be no clarity about the likely endorsability status of these countries and is therefore actively working to, where possible, finalise the assessments and conclude relevant cooperation agreements in the first quarter of 2012. Although ESMA expects to be able to adopt its endorsement decision for the majority of such countries – which will allow for the permanent endorsement of the overwhelming majority of the third-country credit

ratings currently used in the EU – ESMA cannot guarantee that it will be able to endorse all such countries by 30 April.

As regards all the other countries (Chile, China, Costa Rica, Dubai, India, Indonesia, Israel, Panama, Russia, South Africa, Sri Lanka, Taiwan, Thailand, Tunisia, Turkey, and Venezuela) for which CRAs applied for endorsement, it is clear that market participants should take precautionary measures before 30 April as it is likely that credit ratings issued in these countries will not be endorsed after that date.

Separately, on 20 December 2011, ESMA adopted its first four draft Regulatory Technical Standards (RTS) on CRAs. In accordance with the CRA Regulation, these four RTS were sent for endorsement to the European Commission. They will be directly applicable in all Member States upon the date of endorsement. These four RTS provide standards of technical nature and cover the following areas:

- the [information](#) to be provided by a credit rating agency in its application for registration, for certification, and for the assessment of its systemic importance to the financial stability or integrity of financial markets;
- the presentation of [the information](#), including structure, format, method and period of reporting, that credit rating agencies shall disclose in accordance with Art. 11(2) and point 1 of Part II of Section E of Annex I;
- the [assessment](#) of compliance of credit rating methodologies with the requirements set out in Art. 8(3);
- the [content and format](#) of periodic reporting to be requested from the credit rating agencies for the purpose of on-going supervision by ESMA.

On 15 November 2011, the European Commission put forward its [proposals to further toughen the EU's CRA framework](#) and deal with perceived outstanding weaknesses. These proposals come in the form of a draft Directive (amending the UCITS and AIFM Directives in respect of the excessive reliance on credit ratings) and a draft Regulation (amending the CRA Regulation), the four main goals of which are:

- to ensure that financial institutions do not blindly rely only on credit ratings for their investments;
- more transparent and more frequent sovereign debt ratings;
- more diversity and stricter independence of credit rating agencies to eliminate conflicts of interest; and
- to make CRAs more accountable for the ratings they provide.

Alongside the proposed texts, the European Commission has issued a press release, its impact assessment and a set of frequently asked questions. These proposals now pass to the European Parliament and the Council (Member States) for negotiation and adoption. An important prospective point will be to understand if the adoption of further measures pursuant to these proposals will have any impact on endorsement and equivalence decisions which are in place at that time, with consequent implications for the continued use for regulatory purposes of ratings prepared by non-EU CRAs.

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Crisis management

On 4 November 2011, the FSB published a new internationally-agreed standard, *Key Attributes of Effective Resolution Regimes for Financial Institutions*, which sets out the responsibilities, instruments and powers that national resolution regimes should have to resolve a failing SIFI; it also sets out requirements for resolvability assessments and recovery and resolution planning for G-SIFIs, as well as for the development of institution-specific cooperation agreements between home and host authorities. The key attributes are the result of work undertaken by the FSB jointly with its members including the IMF, World Bank and the standard-setting bodies. The G20 and the FSB are calling on countries to undertake the reforms necessary to implement this standard, which will require legislative changes, significantly stepped up cooperation amongst authorities across borders and reviews by firms and competent authorities of G-SIFI business structures and operations to improve recovery and resolution planning. The FSB will initiate an iterative process of peer reviews of its member jurisdictions to assess implementation of the key attributes beginning in 2012 and extending into 2013.

On 21 December 2011, the ECB published a [legal working paper](#), *Crisis Management and Bank Resolution: Quo Vadis, Europe?* This paper considers that well-designed bank resolution regimes are essential not only to meet the acute need of a credit institution in crisis but also to ensure that proper incentive structures operate in the market prior to any crisis. It finds that existing regimes are inadequate and incentive structures have proven to be fundamentally destructive. The paper summarises the main legal challenges for crisis management of ailing credit institutions and identifies the key features of an effective bank resolution regime, assessing and comparing the UK and



An EU crisis management regime is expected to be an even more ambitious step, with the potential to achieve a quantum leap.

German approaches. In addition, the paper analyses the emerging response at European and international level, focusing in particular on bail-ins, the suspension of netting and other rights, treatment of groups and systemically important financial institutions.

At the international level, the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions* is seen to constitute a breakthrough in the development of a global resolution regime. At the EU level, the [European Commission's proposal](#) for an EU crisis management regime is expected to be an even more ambitious step, with the potential to achieve a quantum leap in the efficient cross-border management of key issues, in particular in the field of bank resolution and insolvency law.

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International securities markets' oversight

ESMA announced that, at its 11 October 2011 meeting, the [Securities and Markets Stakeholder Group](#) (MSG) had elected Guillaume Prache, Managing Director of the Federation of European Investors (EuroInvestors), as its first chair, for a term of two years. Also elected to support him were two vice-chairs: Judith Hardt, Secretary General of the Federation of European Securities Exchanges (FESE), and Peter de Proft, Director General of the European Fund and Asset Management Association (EFAMA). Then, on 19 October 2011, ESMA published the [rules of procedure](#) for the MSG, as also agreed at the MSG's meeting on 11 October 2011. These cover topics such as membership, meetings, decision-making, working groups, confidentiality, reporting and collaboration.

On 12 October 2011 IOSCO's Secretary General, Greg Tanzer, addressed a speech on IOSCO's role in [Building a Better Financial System](#) to a group of experts on international standards of accounting and reporting. He highlights that IOSCO is now recognised as the global securities-markets standards-setter by the G20, the IMF and the World Bank, as reflected in the fact that IOSCO now have two seats on the FSB, representing the more developed markets and also emerging markets jurisdictions. He goes on to discuss how IOSCO aims to contribute to the goals of achieving investor confidence and global financial stability. In doing so he covers: IOSCO's disclosure and transparency objectives; response to the financial crisis; current work streams; and standard setting and capacity building roles.

On 18 October 2011, IOSCO released the finalised version of its [revised Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation](#). The 38 applicable IOSCO Principles cover the Regulator; Self Regulation; Enforcement of Securities Regulation; Cooperation in Regulation; Issuers; Auditors, Credit Rating Agencies, and Other Information Service Providers; Collective Investment Schemes; Market Intermediaries; Secondary Markets; and Clearing and Settlement. This Methodology is designed to provide IOSCO's interpretation of the Principles and give guidance on the conduct of a self-assessment or third-party assessment of the level of Principles implementation; and evidences IOSCO's continued commitment to the establishment and maintenance of consistently high regulatory standards for the securities industry. All of the topics addressed in this Methodology are already the subject of IOSCO reports or Resolutions.

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The future of self regulation – a renaissance?



Personal view
by Richard Britton,
Senior Adviser, ICMA

What will be the role of self regulation in the new regulatory landscape which is emerging from the global economic crisis? Legislators, regulators and market participants are viewing with growing concern the deluge of new regulation to which securities market are to be subject in the next few years.

This would be challenging to develop, comply with and enforce at any time. It is particularly daunting in a period of austerity, budget cuts, tax increases, declining profitability of those subject to regulation and great uncertainty as to the economic future of the euro area. Statutory regulators will not be immune from the pressure to produce more with less.

In some quarters, particularly in the EU, self regulation is alleged to have failed to curb the excesses that led to the crisis, such as excessive leverage, the creation of over-elaborate and opaque products and inadequate due diligence by institutional investors. It is not always clear what its detractors mean when they refer to self regulation. Certainly internal risk

management and control mechanisms inside many financial institutions proved inadequate to respond effectively to the risks embedded in one of the greatest bull markets in credit ever seen. Credit rating agencies proved poor at managing conflicts of interest inherent in their “issuer pays” business model. But these failings were largely outside any form of external regulation identified by statutory regulators. Or if they were identified, their significance was seriously under-estimated by regulators and governments as a source of systemic risk.

It is generally acknowledged that self regulation as carried out by organisations external to the firms performed rather well before and during the crisis and continues to do so today. That view is supported by the global standard setter for securities market regulation the International Organization of Securities Commissions (IOSCO). In its 2011 update of the *Objectives and Principles of Securities Regulation*, IOSCO states that “SROs can be a valuable complement to the regulator in achieving the objectives of securities regulation”. Among the benefits of self regulation it has identified the “ability of SROs to require the observance of ethical and business conduct standards from their members which go beyond government regulations”. It recognises that “SROs may offer considerable depth and expertise regarding market operations and practices, and may be able to respond more quickly and flexibly than the government authority to changing market conditions”. It also acknowledges that a member-funded SRO can reduce the burden of the cost of regulation on taxpayers.

That last point is of particular relevance today. The deluge of new legislation in the US and EU is already imposing enormous pressures in the area of policy formulation and will in due course exert similar pressure on supervision and enforcement. There is a growing risk that what emerges will be insufficiently thought-through regulation with unintended and negative consequences,



Could self regulation take on some of the functions currently envisaged as being part of an enhanced role for statutory regulators?

enforced by budget-constrained statutory regulators in a heavy-handed manner in which compliance with the detail takes precedence over promoting a rule's underlying objective.

There may be a better way. Could self regulation take on some of the functions currently envisaged as being part of an enhanced role for statutory regulators? Self regulation has the potential over statutory regulation to be more efficient, knowledgeable, flexible and responsive to the changing needs of intermediaries, issuers and investors. Now, while emerging regulation is in a state of flux, is the time to have the debate.

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Sovereign Bond Markets

CACs, transparency and Stability Bonds

CACs: As reported in the [Fourth Quarter Newsletter](#), ICMA – supporting the work of the EFC's [EU Sovereign Debt Markets Group](#) (SDMG) – contributed significantly to ongoing work to formulate collective action clauses (CACs) in euro-area sovereign securities, as anticipated by the European [Council conclusions of 25 March 2011](#). The views expressed in ICMA's [response to the limited consultation](#) formed the most comprehensive of responses to the proposals and ICMA's views were echoed by many other respondents.

ICMA has continued its discussions with the SDMG and other key parties regarding the proposed CACs. Taking into account important elements of the consultation feedback, the SDMG and its advisors have now agreed upon the form of standardised CAC language which they propose for adoption in all euro-area debt securities issuances (of greater than one year) as from mid-2013. ICMA understands that this agreed language seeks to address the concerns it raised in its response and is confident that its process of active engagement with the SDMG has allowed it to make a valuable contribution to this important exercise. It is expected that final official approval for the proposed language will be obtained in January, following which ICMA will assist the SDMG in making the market aware of the agreed details.

Transparency: Alongside its work on the CACs, ICMA has also raised the topic of transparency with the SDMG, focussing in particular on the importance of the full terms and conditions of all issues being readily available, ideally in English for the benefit of international investors and, to the extent practical, in a standardised way. ICMA understands the SDMG is considering this topic and looking to see where there may be need for any improvements to ensure that all its participant debt management offices are meeting adequate transparency standards. ICMA will continue to review this topic in its prospective dialogue with the SDMG.

Stability Bonds: The European Commission's [Green Paper](#) on the *Feasibility of Introducing Stability Bonds* was published on 23 November. This discusses the concept of certain euro-area sovereign bond issuance would move from the national to the euro-area level. The Green Paper considers three approaches:

- (1) the full substitution of Stability Bond issuance for national issuance, with joint and several guarantees;
- (2) the partial substitution of Stability Bond issuance for national issuance, with joint and several guarantees; and
- (3) the partial substitution of Stability Bond issuance for national issuance, with several but not joint guarantees.

In evaluating the respective feasibility of these options, the evident starting point is to focus on the differences which exist

between them. We consider that the two major features to examine are as follows:

- “full” versus “partial” substitution – being the difference between the approaches (1) and (2); and
- “joint and several” versus “several but not joint” guarantees – being the difference between the approaches (2) and (3).

Responses to the Green Paper were requested by no later than 8 January and ICMA has [submitted a short response](#). In responding, ICMA focussed its comments on technical aspects of Stability Bonds' issuance, leaving aside questions regarding whether such issuance is, or is not, desirable; and ICMA chose not to consider Treaty change implications. Included as an integral part of ICMA's response, there is a section, which was prepared specifically by ICMA's buy-side Asset Management and Investors Council. Given that investor acceptance will be a crucial factor in the actual feasibility of any Stability Bond issuance proposal, ICMA included this input in its entirety and emphasised the importance of taking full account of these views.

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ICMA's new Public Sector Issuer Forum

ICMA's goal is to represent all participants in the capital markets – issuers, intermediaries and investors. So far at ICMA, public sector issuers have interacted with ICMA through an existing Council run in Paris, called the AMTE – Euro Debt Market Council, which has an additional monitoring role with respect to the market making obligations of the French primary dealers (SVTs).

Sovereign, supranational and agency issuers (SSAs) will dominate issuance in the years to come and are playing an increasingly important role in the capital markets. We believe that there is a need for a neutral forum for these issuers to come together to discuss market-related issues of mutual interest. Accordingly ICMA's Board has decided to build a specific Public Sector Issuer Forum (PSIF) for these issuers to address their own specific concerns. The need for this Forum has already been validated by a number of potential members, and the Forum will become operational in early 2012.

This follows the existing model of ICMA's Financial Institutions Issuer Forum, set up in 2010, whose members comprise those banks that are the most active in issuing debt in the European markets. This forum addresses topics which are of mutual interest to bank issuers such as the impact of the bail-in proposals on senior unsecured debt and the market for contingent convertibles, amongst others.

Indeed, our experience shows that the existence of a specific forum to hold confidential market practices discussions in a neutral, apolitical and cooperative environment, coupled with the ability to interact systematically with the other parts of the market which are represented in other ICMA committees (such as the syndicate community through our Primary Market Practices

Committee, the secondary dealers through our Secondary Markets Practices Committee and investors through the Asset Management and Investor Council) is a worthwhile and successful model to broaden information exchange across all SSA categories through a well-focused, relevant, market-practice led agenda.

There are a number of other points to make:

- First, the agenda of the Forum is critical to its success and will be driven by the Forum members themselves. We expect the Forum to select relevant market topics to address while drawing from ICMA expertise with a focus on market practices such as debt buyback guidelines, improving transparency in disclosing terms and conditions for government borrowers, new issue processes and technical aspects of "Stability Bonds". Some of the agenda will be in response to initiatives from other parts of the markets (for example, responding to buy-side initiatives and to regulatory initiatives).
- Second, it is critical that coordination and cooperation are maximised to ensure that the agenda does not duplicate work being undertaken by existing industry groups outside ICMA. For government or SSA issuers there is the EFC's "Mills" DMOs Committee at the European level, the Government Borrowers Forum (with the World Bank as its secretary) at the global level, which also has a sub-group of supranational and agencies, and the OECD Government Borrowers Group. ICMA has contacted all three and arranged for them to join the PSIF as observers to ensure that there is full coordination and duplication is minimised.

- Third, membership will be open to sovereign debt issuers, supranationals and agencies undertaking debt capital markets transaction in the European markets. In principle, there will be four meetings per annum. Working groups will be set up as and when necessary to look at specific issues as directed by the PSIF. ICMA will provide a secretariat, based in Paris, to facilitate the running of the Forum.

In conclusion, particularly in the current challenging market environment, we expect the new Forum to contribute efficiently in supporting and promoting the successful activities of the SSA issuers in Europe by providing an active dialogue and transfer of know-how among members, highlighting relevant issues and proposing market-led initiatives and solutions while engaging in an efficient and systematic interface with investors, primary and secondary dealers, other sell-side members and financial services providers, through ICMA's committees.

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Short-Term Markets

European repo market

FSB on shadow banking: On 27 October 2011, the FSB announced the publication of its report on *Recommendations to Strengthen Oversight and Regulation of Shadow Banking*. Amongst other things, this report describes work plans for the five workstreams which were announced in September, included amongst which is the regulation of securities lending/repo activities. ICMA's European Repo Committee (ERC Committee) is already actively engaged in the work now being advanced under this workstream, which is being managed as an FSB group encompassing broad international involvement and being led by David Rule from the UK FSA.

Most recently, the Bank of England hosted a meeting of this workstream on 1 December 2011, with the first agenda item being *Repo Market with Specific Focus on Europe* – market input for this was provided by the involvement of Godfried De Vidts (Chair of ICMA ERC) and three other ICMA ERC Committee members. ISLA were also involved in this meeting with respect to securities lending and the ERC are maintaining ongoing regular contact with ISLA.

EU short selling: New rules for short selling and CDS have been adopted in the form of a Regulation which should enter into force in November. The Regulation contains provisions in three areas – transparency, restrictions on naked short selling and regulatory powers. This is described in more detail in the secondary markets section of this Quarterly Report, but it is pertinent for repo market participants particularly to note its provisions relating to short sales of sovereign debt. The Regulation provides that disclosure of such short sales should only extend to regulators, as public disclosure could have a detrimental effect on sovereign debt markets where liquidity is already impaired. The restrictions on naked short selling of sovereign bonds require that the bonds either need to be located or there has to be a reasonable expectation that settlement can be effected when due. A competent authority may suspend the restriction where the liquidity of the sovereign debt falls below a pre-determined threshold.

Accounting rules regarding netting: On 16 December 2011, the IASB and FASB issued *Common Offsetting Disclosure Requirements* intended to help investors and other financial statement users better

to assess the effect or potential effect of offsetting arrangements on a company's financial position. The common disclosure requirements also improve transparency in the reporting of how companies mitigate credit risk, including disclosure of related collateral pledged or received. The disclosures are effective for annual periods beginning on or after 1 January 2013.

Unlike IFRSs, US GAAP allows companies the option to present net in their balance sheets derivatives that are subject to a legally enforceable netting arrangement with the same party where rights of set-off are only available in the event of default or bankruptcy. To address these differences between IFRSs and US GAAP, in January the IASB and the FASB issued an exposure draft that proposed

In brief

An update on new developments relating to shadow banking and short selling as they affect the repo market; and also on new accounting rules regarding netting from the IASB and FASB.

new criteria for netting that were narrower than the current conditions currently in US GAAP. However, in response to feedback from their respective stakeholders, the boards decided to retain their existing offsetting models and instead issue new disclosure requirements.

In addition to the new disclosure requirements, the IASB also decided separately to provide additional application guidance for offsetting in accordance with IAS 32. This guidance is aimed at addressing current practice issues identified during outreach. This guidance clarifies: (a) the meaning of “currently has a legally enforceable right of set-off”; and (b) that some gross settlement systems may be considered equivalent to net settlement.

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ECP market

Shadow banking: On 27 October 2011, the FSB announced the publication of its report on *Recommendations to Strengthen Oversight and Regulation of Shadow Banking*. Amongst other things, this report describes work plans for the five workstreams which were announced in September, namely regulating banks' interactions with shadow banks; regulatory reform of MMFs; regulation of other shadow banks; regulation of securitisation; and regulation of securities lending/repo activities.

In brief



The article contains an update on developments which affect the Euro Commercial Paper market, specifically highlighting the work of ICMA's ECP Committee in the area of money market funds which are important investors in ECP.

ICMA's ECP Committee – working closely with IMMFA, which actively addresses these MMF issues – will be keeping a close eye on the “money market funds” workstream, in the same way as for any other regulatory topic affecting MMFs which are important investors in the ECP product. Similarly, ICMA's ECP Committee will also be keeping an eye on the “securitisation” workstream, since ABCP inevitably becomes caught under the securitisation umbrella (in this case working closely with AFME, which actively leads much of the work done on securitisation topics). Finally, given the use that entities such as conduits and SIVs have historically made of commercial paper financing, the interests of ICMA's ECP Committee may also extend to the workstream on “regulation of other shadow banking entities”.

Money market funds: At the IMMFA Annual General Meeting in June 2011, amendments were approved to the IMMFA *Code of Practice*. These amendments included new risk management requirements, designed to limit credit and liquidity risks. The risk mitigation mechanisms are supported by additional disclosure requirements in order to allow investors better to compare, contrast and assess risk. IMMFA

members had until December 2011 to achieve compliance with the new obligations contained in the Code.

Bank of England asset purchase facility: Having remained unused throughout the year, the Bank of England's (the Bank's) commercial paper facility closed on 15 November 2011, in line with the Bank's provision of 12 months' notice of its intention to withdraw this scheme. The Bank continues to offer to purchase secured commercial paper (SCP) backed by underlying assets that are short term and provide credit to companies or consumers that support economic activity in the UK. The Bank also announced in November 2010 that it had made a programme eligible for this facility; and this programme has subsequently issued SCP.

ABCP: On 17 November 2011, Moody's hosted its 9th annual ABCP conference. This reasonably well attended event comprised a series of panel discussions and presentations on different aspects of the ABCP market's recent evolution, encompassing viewpoints from issuers through to investors. A presentation on regulatory issues focussed on aspects of the revised rules regarding retentions, the capital treatment of resecritisations and the coming liquidity requirements. It also flagged that there are many other regulatory changes which will bear upon the market.

On a related note, following from its May 2011 consultation, on 3 November 2011 the UK FSA issued *PS11/12: Strengthening Capital Standards 3 - Feedback and Final Rules for CRD3*. Paragraphs 4.5 (at page 24 of the report) and 4.9 (at page 30 of the report) provide feedback of specific relevance to the treatment of ABCP structures.

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Total Net Cash Outflows in the Liquidity Coverage Ratio

It has been a year since the Basel Committee on Banking Supervision (BCBS), as part of the Basel III accord, published its *Liquidity Paper*, with the aim of strengthening the liquidity risk management of internationally active banks. Since then, regional and national authorities have started to implement these rules in their jurisdictions, and market participants have been working hard in order to avoid direct, as well as indirect, adverse consequences coming from the new liquidity standards.

Over the last three editions of this Newsletter, we have been looking at the main features of the two liquidity ratios introduced by the new rules: the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), together with a comparison between the Basel III text and the implementation proposal by the European Commission in July 2011. With regard to the LCR, we have paid particular attention to the definition of the “stock of high quality liquid assets”, which is the numerator of the ratio and represents a key topic for our members. Complementary to this, we now analyse the LCR denominator, ie “Total Net Cash Outflows”.

In a nutshell, the LCR requires banks to have enough cash (or cash equivalent securities) to meet net cash outflows over a short (30-day) period of acute stress. A bank must therefore calculate the cash outflows and cash inflows to which it can expect to be subject over that 30-day period, recognising that it is likely to have increased commitments and less available resources as a result of the acute stress, and then maintain a buffer of high-quality

liquid assets equal to or greater than its expected net cash outflow. The kind of stress scenario envisaged by the Basel Committee is a combined idiosyncratic and market-wide shock similar to the one experienced during the crisis which started in 2007, including impacts such as a run-off of a proportion of retail deposits, and a partial loss of unsecured wholesale funding capacity. The BCBS *Liquidity Paper* defines the parameters for the stress scenario, the stock of high-quality liquid assets, and the calculation of the Total Net Cash Outflows.

The Total Net Cash Outflows are the total expected cash outflows minus the total expected cash inflows over the 30-day period of acute stress. The expected cash outflows are calculated by multiplying outstanding balances of various categories of liabilities and off balance-sheet commitments by rates at which they are expected to run off or be drawn down. The expected cash inflows are calculated by multiplying the outstanding balances of various categories of contractual receivables by rates at which they are expected to flow in under the stress scenario, up to an aggregate cap of 75% of total expected cash outflows. This 75% cap means that a bank must therefore maintain a minimum stock of high-quality liquid assets equal to 25% of the total amount of outflows accumulated over the 30-day period of acute stress being tested.

The BCBS *Liquidity Paper* contains a good level of detail regarding the treatment of assets and liabilities that must be taken into account for the purposes of the Total Net Cash Outflows,

together with the run-off rates assigned to them. Banks are not allowed to double count items – ie count, as cash inflows, assets which have already been included as part of the “stock of high-quality liquid assets”. Additionally, the paper considers a list of liquidity risk-sensitive obligations, such as contingent funding obligations, which are expected in a stressed scenario and for which banks are required to account in their calculation of the Net Total Cash Outflows.

Turning to the implementation of Basel III in the EU, the liquidity provisions have been included in the Capital Requirements Directive (CRD IV) proposed by the European Commission in July 2011, and which envisages both a Directive and a Regulation. This proposal is currently under legislative discussion in the European Parliament and the European Council, with the aim of it becoming effective from 1 January 2013.

Unlike Basel III, CRD IV is less prescriptive in determining the LCR, and it states only that banks have an obligation to hold sufficient liquid assets to be able to address any imbalances of liquidity inflows and outflows under stressed conditions over a short period. The immediate focus of the EU proposal is to require banks to report on their holdings of qualifying liquid assets and, with regard to the Total Net Cash Outflows, on the maturity profiles of their liabilities. The objective is carefully to analyse the various components of the ratio during the observation period, before setting any prescriptive standard in 2015.

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by Ruari Ewing

Primary Markets

The Prospectus Directive (PD) regime: First implemented in 2005, the PD regime governs the content, approval and publication of prospectuses for the admission of securities to trading on EEA-regulated markets and their non-exempt offering in the EEA. It consists of the Level 1 Directive itself (transposed by EEA national laws) and a Level 2 PD implementing Regulation (which is directly applicable under EEA national laws, without specific transposition being required). A first review of the PD regime has been under way since 2009.

Prospectus Directive Review

The first review of the Prospectus Directive (PD) continues towards its 1 July formal implementation date.

At Level 1 of the PD, EEA Member States are proceeding towards transposing *inter alia* the [PD Amending Directive](#) into national law by the required deadline of 1 July. Most recently, consultations in this respect have been published regarding transposition in [France](#) (deadline 28 December 2011) and the [United Kingdom](#) (deadline 13 March). Market participants will likely be liaising with their legal counsel to keep track of any unusual transpositions, whether in terms of content or timing, and to identify whether there may be any consequential impacts on any intended passporting of transactions. This may notably concern any early transposition of the increase of the “wholesale” threshold from €50,000 to €100,000 noted in prior editions of this Newsletter. However, much of the market has already moved to the new threshold, as it will be applicable to securities admitted, from the beginning of 2011, to trading on EU-regulated markets and also to preserve some ability to tap prior transactions.

The PD Amending Directive requires the European Commission to adopt various implementing delegated acts at Level 2. Several of these acts are required to be adopted by 1 July, namely concerning: (i) the format of the prospectus, base prospectus, summary, final terms and supplements; and (ii) the detailed content and specific form of the key information to be included in the summary. In early 2011, the Commission [requested](#) ESMA to provide formal advice on the following points:

- (1) the final terms format;
- (2) the summary format and related key information content and format;
- (3) a proportionate disclosure regime for certain discrete contexts (with limited application to the international bond markets);
- (4) consent to the use of a prospectus in a retail cascade;
- (5) the provisions of the existing PD implementing Regulation;
- (6) the equivalence of third-country regimes; and
- (7) liability regimes applied by Member States.



The consultation contemplates mandatory public disclosure of any consent for intermediaries to use an issuer's prospectus.

In this respect, the [2011 Fourth Quarter edition](#) of this Newsletter noted the publication of the [first instalment of formal advice](#) by ESMA to the Commission, covering points 1 to 3 of the Commission's request. This, though leaving several aspects for later follow-up, largely retained the proposals of its [preceding consultation](#) (discussed in the [2011 Third Quarter edition](#) of this Newsletter). ICMA has since been engaging with the European Commission and European Parliament to highlight on-going concerns with the concept of an issue-specific summary, the rigid approach to the permissible content of final terms (on the basis of the proposed "A", "B" and "C" categorisations of specific information items listed in the PD implementing Regulation) and the rigid approach to the permissible form of final terms (notably in relation to the use of consolidated conditions and the prohibition of "non-applicable" line items). In addition, the Joint Associations Committee on retail structured products, of which ICMA is a member, submitted on 7 December 2011 a [response](#) to the Commission on ESMA's formal advice, setting out some of these and other concerns in more detail. The ESMA advice stated that the new requirements relating to points 1 and 2 of the Commission's request should only apply to prospectuses and base prospectuses approved from 1 July. In this respect, market participants will be particularly interested (in relation to any pre-July programme update decisions) to see the text of the final delegated acts (likely to take the form of an amending Regulation to the PD implementing Regulation) when, as required, they are submitted to the European Council and the European Parliament for a three month objection period (extendible to six months). As these acts must be adopted by 1 July, submission is expected very early in the New Year, potentially even before publication of this Newsletter article.

On 13 December 2011, ESMA published a [consultation](#) concerning a second instalment of its Level 2 advice, covering points 4 and 5 of the Commission's request. [ICMA has filed a response](#), despite the very tight deadline of 6 January (little more than three weeks, including the Christmas and New Year holiday period), which means that some ICMA members may not have been able to contribute fully and that ESMA will benefit from a less detailed understanding than it otherwise might have done.

The consultation contemplates mandatory public disclosure of any consent for intermediaries to use an issuer's prospectus (potentially in the prospectus itself), including its duration, any related conditions and the identities of the intermediaries concerned. The requirement for such consent to exist is crucial to an issuer to help control its prospectus liability. Publication of consent, however, is not a material consideration for retail investors – if evidence of consent is produced by an intermediary when needed (notably in a complaint context), then liability will attach to the issuer; if not, then liability will attach to the intermediary (who is MiFID regulated and subject to insurance and compensation obligations). Mandatory public disclosure, particularly in the prospectus itself, would effectively

impose pre-set and rigid distribution networks and so risks substantially hampering the ability of European businesses, which need capital in difficult times, and European savers, who need investment choices in the expectation of state pension shortfalls, to meet in the market – since only a proportion of likely demand for securities (including interested intermediaries) can be identified, and so pre-set, by issuers at the outset of an offer.

Regarding tax withheld "at source", the consultation contemplates prospectus disclosure of net amounts to be received by investors. There seems here to be some confusion between withholding "at source" (ie in the hands of the issuer and its official agents so known and able to be disclosed) and "downstream" withholding in the hands of intermediaries, notably investors' own custodians (innumerable permutations unknown to the issuer concerned and so unable to be disclosed and in any case subject to disclosure under MiFID by the intermediaries concerned). The consultation also addresses disclosure relating to indices composed by the issuer, the nuance between profit forecasts/estimates and preliminary statements and the number of required years of audited historical financial information.

The advice ESMA ultimately formulates covering points 4 and 5 will be considered by the Commission in its formulation of further delegated acts, which will also be subject to an objection period before the Council and Parliament. Given the 1 July timeline noted above for the initial delegated acts on points 1 to 3, it seems likely that the further delegated acts will take the form of a further amending Regulation. Hopefully, any programmes already updated to take account of the initial amending Regulation will not be mandated to be immediately updated again. However there may still be a risk that issuers will find some provisions sufficiently valuable to feel compelled to do so anyway. In this respect, any agreement by Commission, Council and Parliament to delay the 1 July deadline regarding points 1 and 2, so that points 1 to 5 can be addressed in a single amending Regulation, would probably avoid unnecessary market disruption (bearing in mind the Level 1 transposition deadline does not depend on a simultaneous coming into force of delegated acts concerning points 1 and 2).

Further ESMA work on the remaining points (6 and 7) of the Commission's request is expected in due course. This should not however be relevant to the launch of the revised PD regime.

A second review of the PD is scheduled from late 2015, with a further requirement for an assessment by the Commission by 1 January 2016, following which it must present a report to the Council and the Parliament, accompanied, where appropriate, by proposals to further amendments. In this respect, ICMA is encouraging decision makers to start now articulating an overall policy on how European securities markets should operate, so that a coherent discussion about the use of individual legislative tools (PD, MAD, MiFID) can be had against a clear policy background prior to any debate concerning specific legislative proposals. In this context, ICMA has recently held two roundtables with members, one in London in October 2011 and one in Brussels in November 2011. These follow an earlier event in Luxembourg in May 2011.

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US Foreign Account Tax Compliance Act (FATCA)

Market representatives continue to make representations to the US authorities in advance of the grandfathering deadline of 18 March noted in previous editions of this Newsletter, and unchanged by the other postponements set out in [IRS Notice 2011-53](#) published on 14 July 2011. In this respect, ICMA filed, with the US Department of the Treasury and Internal Revenue Service on 16 November 2011, a [request for clarification](#). The request focused on the reliable identification of non-compliant intermediaries, financial subsidiaries of non-financial companies, fungibility of post-18 March debt issuance with earlier (grandfathered) issuance, loss of grandfathering consequent on any post-18 March significant change in terms, commercial paper and structured finance vehicles. It also focused on a related TEFRA aspect – immobilised global bearer bonds within the two ICSDs, Euroclear and Clearstream. In the absence of timely guidance, the 18 March 2012 grandfathering deadline may well need to be extended if the US authorities wish to minimise disruption to securities issuance.

The FATCA regime: Enacted in the US in March 2010 as part of the Hiring Incentives to Restore Employment Act, the FATCA regime will notably:

- require intermediaries effecting US source payments to enter into more substantial account reporting agreements with the US Internal Revenue Service (backed by a 30% withholding obligation on payments by compliant intermediaries to non-compliant accounts); and
- repeal (except for non-US issuers seeking to avoid the US excise tax on bearer debt) the Tax Equity and Fiscal Responsibility Act (TEFRA) exemptions relating to bonds in bearer form (with substantial resulting fiscal sanctions on bearer bonds of US issuers, namely loss of portfolio interest exemption from 30% withholding tax and non-deductibility of interest for corporation tax) – however, bonds held in a dematerialised book-entry system, or other system specified by the US Treasury, will be deemed to be in registered form for US tax purposes.

Notwithstanding the absence of further guidance, issuers (except for non-US non-financial issuers) and their advisers may well, in the run-up to 19 March, be considering what (if any) changes to their issuance documentation may be appropriate. Specifically, consideration is likely to be given to whether a FATCA withholding obligation is likely to arise, either “at source” (ie in the hands of the issuer or its agents) or “downstream” (for example in the hands of investor’s own custodians). In the earlier case, an analysis of the terms and conditions (particularly the payments and taxation provisions) traditionally applicable to an issuer’s securities (and any related agency agreements) may be relevant to determine whether the default outcome is the desired one. In the latter case, consideration of such terms and conditions may not be relevant, notably in an immobilised global security context where the terms and conditions only apply to payments due to the holder of the global security (ie the depositary for the relevant clearing system). Some issuers may consider the likelihood of a FATCA withholding obligation arising in practice to be very low – because issuer agents and clearing system depositaries will be required by their principals to be FATCA-compliant or because downstream custody chains will eliminate any non-compliant custodians. If so, then this may affect any issuer consideration of any potential changes (including as to whether specific or generic) to terms and conditions (in the “at source” context noted above) and/or to prospectus disclosure – whilst maintaining overall consistency between the two.

Regarding the related TEFRA aspect concerning immobilised global bearer bonds within the two ICSDs, it seems likely, unless they receive alternative US tax advice, that non-US issuers will find it simplest to continue relying on TEFRA from 19 March, as they do currently. US

issuers may with their advisers wish to weigh more carefully the likelihood of immobilised global bearer bonds within the two ICSDs being ultimately deemed to be registered form for US tax purposes (in relation to any local unfavourable treatment – eg from a tax, negotiability or listing perspective) against the alternative of immobilising global bonds within the two ICSDs in registered rather than bearer form.

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Transparency Directive

On 25 October 2011, the European Commission published a [draft Directive](#), to amend the Transparency Directive. The proposals contained in the draft Directive arise out of the Commission’s [Consultation on Modernising the Transparency Directive](#), which was published in May 2010. The main amendments are as follows:

- The obligation to present quarterly financial information (ie interim management statements/quarterly reports) will be abolished for all listed companies. Member States will be prevented from imposing such a requirement in national legislation, though listed companies may continue voluntarily to publish such information.
- ESMA is tasked with preparing non-binding guidance on the narrative content (ie management report) of financial reports for all listed companies.
- The regime for notification of major shareholdings will be extended to all financial instruments with an economic effect similar to holdings of shares and entitlements to acquire shares, whether giving right to a physical settlement or not – ie cash-settled derivatives will be brought within the scope of the regime.

Officially Appointed Mechanism: The Transparency Directive (TD) created the concept of an officially appointed mechanism for the central storage of regulated information (OAM). Issuers are required, by the TD, to make regulated information available to the OAM. Member States must officially appoint at least one mechanism for the central storage of regulated information. OAMs must comply with certain minimum quality standards of security, certainty as to the information source, time recording and easy access by end users. The TD encourages the establishment of some kind of interconnection of the OAMs across Member States.

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- The rules regarding the aggregation of holdings of shares with those of financial instruments giving access to shares (including cash-settled derivatives) will be harmonised for the purposes of calculation of notification thresholds. Netting of long and short positions will not be allowed.
- A default home Member State will be established for third-country issuers that fail to choose a home Member State in accordance with Article 2 of the Directive.
- Listed issuers active in an extractive industry (ie oil, gas and mining) or primary forest-logging industry will have to make annual disclosures of any payments they have made to governments in the countries in which they operate.
- The European Commission will be given further powers to enhance the current network of officially appointed storage mechanisms (OAMs), especially regarding access to regulated information at EU level. ESMA will assist the Commission by developing draft regulatory technical standards concerning the operation of a central access point for the search of regulated information at EU level. These measures will also be used to prepare for the possible future creation of a single European storage mechanism.
- The sanctioning powers of competent authorities will be enhanced.

The draft Directive recognises that access to regulated information (ie all information which an issuer is required to disclose under the TD and MAD) on a pan-European basis is currently overly complicated. The 27 different national databases are not sufficiently interconnected, which makes pan-European access to information problematic for investors. The draft

Directive appears to advocate the approach set out in the *Feasibility Study for a Pan-European Storage System* carried out by Actica Consulting and published on 18 October 2011. The Study recommended that all the national OAMs be replaced with a single European OAM which would store all European data and provide all search facilities. The Study recognised that it would take time to transform the current arrangements into a single European OAM. The Study suggested that, in the interim, the Commission could usefully start to develop a central database for all data and metadata (ie data that describes other data), which would hold copies of all the data and metadata stored by the national OAMs.

Points raised by ICMA in its [August 2010 response](#) to the Commission's 2010 consultation are not addressed in the draft Directive, notably:

- a TD/PD mismatch on grandfathering of the increase in the €50,000 "wholesale" thresholds to €100,000 (PD grandfathering expires from actual national transposition, due by 1 July whilst TD grandfathering expired on 30 December 2010);
- a TD/PD mismatch on exemption for non-EEA states guarantees (under the TD only EEA-sovereign guaranteed issuers benefit from a reduced regime); and
- the TD requirement for publications to be in full unedited text.

The draft Directive is now being considered by the European Parliament and Council for adoption.

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EBA bank recapitalisation plan

Core Tier 1 capital

The European Banking Authority (EBA) published on 8 December 2011 its [formal recommendation](#), together with a supplementary [Q&A](#) and the [final figures](#), relating to banks' recapitalisation requirements. The recommendation states that national supervisory authorities should require certain [credit institutions](#) to strengthen their capital positions by building up an exceptional and temporary capital buffer against sovereign debt exposures to reflect market prices as at the end of September 2011, and establish an exceptional and temporary buffer so that Core Tier 1 capital ratios reach a level of 9% by the end of June.

The sovereign capital buffer is a temporary measure and, once the deployment of the new [European Financial Stability Facility](#) (EFSF) capacity becomes effective in addressing the sovereign debt crisis by lifting sovereign bond valuations from today's distressed prices, the EBA will reassess the continued need for and size of capital buffers against banks' sovereign exposures.

With the potential danger that the mass disposal of sovereign bonds would be likely to make the sovereign debt crisis even worse, the EBA has stressed that the sovereign capital buffer component of the bank recapitalisation requirements is a fixed amount calculated on the basis of data from the end of September 2011 and that therefore sales of sovereign bonds will not count towards the 9% Core Tier 1 capital ratio requirement to be achieved by the end of June.

The EBA has stipulated that banks should first use private sources of funding to strengthen their capital position to meet the required target, including: retained earnings; reduced bonus payments; new issuances of common equity; and

suitably strong contingent capital and other liability management measures. National supervisory authorities may, following consultation with the EBA, agree to the partial achievement of the target by the sales of selected assets so long as it does not lead to an excessive cut in lending – the recapitalisation plan is after all a response to a crisis of confidence in Europe's banks, which has contributed to banks' difficulties in securing wholesale funding and, as a consequence, is threatening lending to the economy, so it would be counterproductive if the measure designed to help banks keep lending meant that they cut loans. Transfers of contracts or business units to a third party are permissible – because sales of whole subsidiaries or business units imply that another party will continue its lending functions – although an unintended consequence of this may be to undermine growth and damage long-term profit as banks divest of some of their more profitable assets to generate capital.

The definition of Core Tier 1 is the same used in the [2011 EU-wide stress test](#) (including existing capital instruments subscribed by governments). This definition of capital comprises the highest quality capital instruments (common equity) and hybrid instruments provided by governments as announced by the EBA for the 2011 EU-wide stress test, and is based on existing EU legislation in the Capital Requirements Directive (CRD). In particular, the commercial instruments included in Core Tier 1 have to be simple, issued directly by the institution itself and able, both immediately and without any doubt, to meet the criteria of permanence, flexibility of payments and loss absorption in going-concern situations. The inclusion of government support measures in this definition reflects the expectation of supervisors that those instruments will be fully available to absorb losses and shelter banks in case of difficulties. Government

In brief



The European Banking Authority (EBA) recommends that national supervisory authorities should require banks to strengthen their capital position by building up a buffer against sovereign debt exposures, and establish an exceptional and temporary buffer so that their Core Tier 1 capital ratio reaches a level of 9% by the end of June.

While private sources of funding should be used to achieve these targets in the first instance, newly issued private contingent convertibles (CoCos) are eligible to be considered as a part of the buffer, if consistent with the EBA's common term sheet.



The ratification of contingent convertibles by the EBA, subject to their characteristics being finalised, may now open the way for the product to evolve.

support measures need to be consistent with the European State Aid rules and approved by the European Commission.

CoCos

However, since buffers are intended to absorb potential (contingent) losses, newly issued private contingent convertibles (CoCos) are eligible to be considered as a part of the buffer if consistent with the common [term sheet](#), as devised by the EBA for this purpose. Existing convertible capital instruments will not be eligible unless converted into Core Tier 1 according to the above definition by the end of October.

As it happens, many of the permitted EBA's CoCo instrument features as contained in the term sheet are in line with Basel III rules on hybrid Tier 1s — the instrument must be perpetual, with mandatorily deferrable and non-cumulative coupons — although it departs from Basel III Tier 1s in its equity conversion trigger. Under Basel III, such instruments would convert to equity when the bank's Core Tier 1 ratio reaches 5.125%. The EBA's CoCo will convert into equity at 7%.

There is a risk that the EBA's CoCo may be perceived as much closer to equity than to fixed income and therefore may not be palatable to the usual fixed income investor base — as it is, any EBA CoCo will need to be undated and will contain a higher trigger, equating to a higher risk of triggering a conversion, a coupon deferral (at the discretion of the regulator) and a call, which would potentially deprive investors of gains.

With characteristics more akin to Tier 2, any such instruments might be easier to place. However, a favourable conversion price can be set (subject to limits imposed by the regulators) and the EBA CoCo can contain an upside conversion option, which may appeal to a more varied pool of investors.

Until now, many national authorities have been reluctant to use contingent capital instruments, although the appetite for European bank CoCos within certain structures and pricing parameters has been extremely high. However, the ratification of contingent convertibles by the EBA, subject to their characteristics being finalised, may now open the way for the product to evolve. As for the wider capital requirements as a whole however, with banks already being forced substantially to reduce the size of their balance sheets through asset sales (subject to the EBA asset sales restrictions), and both asset values and capital cushions decreasing generally, some institutions may find compliance is not straightforward.

As for next steps, the recommendation indicates that national authorities will require banks to submit, by 20 January, their capital plans detailing the actions they intend to take to reach the targets. Agreement on these capital plans will be deferred until they have been reviewed, shared and consulted on with the EBA and with other relevant competent authorities within colleges of supervisors, as appropriate. National authorities will seek to ensure that, throughout the colleges' discussions of capital plans,

the need to maintain exposure levels of banking groups in all Member States is taken into account, bearing in mind that if and where necessary the EBA will use its mediation role to that effect.

The EBA has noted that these measures form part of a broader European package, agreed by the European Council on 26 October 2011 and confirmed during the ECOFIN Council on 30 November 2011, to address the current situation in the EU by restoring stability and confidence in the markets with the aim of maintaining lending into the real economy. The suite of EBA recommendations will clearly be of great significance to the ICMA [Financial Institution Issuer Forum](#), which gathers the major financial institution group issuers from amongst ICMA's members to discuss issues of common interest to them. Please contact Katie Kelly to register your interest in joining the Financial Institution Issuer Forum.

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Other primary market developments

Review of the Market Abuse Directive:

On 20 October 2011, the European Commission published a [proposed Regulation](#) on insider dealing and market manipulation to replace the current [Market Abuse Directive](#). It also published a [proposed Directive](#) relating to criminal sanctions. Many of the issues arising in this context are not specific to the bond markets and are being addressed by many industry bodies. ICMA has since been engaging with the European Commission and European Parliament to highlight several discrete aspects, notably: (i) concerns with the impractical widening of the inside information concept to include all information not generally available but which would be otherwise regarded as relevant in deciding transaction terms; and (ii) the apparently accidental restriction of the stabilisation safe harbour to own shares.

Stabilisation in the ICMA Primary Market Handbook:

In the [ICMA Primary Market Handbook](#) (available to subscribers and to ICMA members), [ICMA Recommendation 1.25, Stabilisation](#), provides that: “Unless otherwise notified to the Stabilising Manager(s) before the start of the stabilisation period, the Co-ordinating Stabilising Manager is the Lead Manager of the issue, in the case of a sole-lead managed issue, or, otherwise, the Joint Bookrunner named as Co-ordinating Stabilising Manager on ICMA terms in the relevant screen invitation, or other invitation to syndicate members”. This method of appointment may not always

be consistent with current transaction dealflow. Consequently, market participants may find it helpful to ensure that coordinating stabilising manager (CSM) appointment is included within the initial kick-off list of responsibilities (together with documentation, billing & delivery, etc). This should enable any syndicate member with a more conservative approach to use of the MAD stabilisation safe harbour than the syndicate member responsible for documentation (the most likely member to otherwise undertake the CSM role) to be appointed as CSM if it so wishes. Distinctly, [ICMA Standard Documentation & Standard Language XI, Market Abuse Directive – Stabilisation Safe Harbour](#), sets out a form of pre-stabilisation announcement that *inter alia* includes a provision for disclosure of offer price that is not required under the Market Abuse Directive itself. Market participants seeking to publish such notices on opening of orderbooks (when only price guidance is available) will necessarily omit offer price disclosure from their notices. ICMA will be reviewing the above two Handbook items in due course with a view to revising them accordingly.

Translation of JAC combined principles:

On 23 November 2011, translations into [French](#) and [German](#) were published of the JAC combined principles published in [English](#) in May 2011.

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by John Serocold

Secondary Markets

ICMA's Secondary Market Practices Committee

The questions I asked in my *Personal View* column a year ago remain pertinent as we look forward to 2012: first, what blend of market structures best suits investors and issuers in the fixed income markets today; and second, how to respond to calls for greater efficiency and transparency?

The current economic conjuncture, overlaid by market participants' concerns about progress in resolving the interlinked questions of sovereign debt and the safety and soundness of the banks, continue to provide a challenging backdrop to ICMA's technical and regulatory work.

A busy period lies ahead for ICMA's revitalised Secondary Market Practices Committee (SMPC) under the Chairmanship of Philippe Rakotovoao of Crédit Agricole's Corporate and Investment Bank. At its inaugural meeting of 2012, the Committee will be asked to consider and approve a work programme covering the following topics:

- a review of ICMA's Secondary Market Rules and Recommendations, in response to evidence gathered from members in 2011;
- regulatory reform, particularly the recast MiFID and the proposed new MiFIR (see below);
- market infrastructure questions, including the development of TARGET2-Securities and European Union proposals for a Securities Law Directive and a Regulation on Central Securities Depositories; and

- operational issues, including ICMA's continuing work on electronic trade confirmation and settlement fails.

The Committee's role will be to oversee the work programme, which will be taken forward by specialist operational groups. Members wishing to participate in, or to be kept informed of the progress of, one or more of these groups are invited to contact me. Work involving the consideration of draft legislative proposals will be taken forward in close collaboration with ICMA's Regulatory Policy Committee.

We envisage that the Committee will meet four times a year. In 2012 we plan to meet in London in January and April, in Paris in early July and in Frankfurt in November.

I set out below a short report on recent activity.

Trade association liaison: We have been liaising with two groups on the MiFID proposals:

- a group of London-based associations, including ABI, AIMA, AFME, APCIMS, BBA, FOA and ISDA;
- a group of Continental European associations, including securities dealer associations in Denmark, France, Italy, the Netherlands, Norway, Spain and Sweden. AFME is also a member of this group.

In each case we have made clear our specific role, shared our key concerns and encouraged the like-minded associations to make the same points as us. We have also shared our draft response to the European Parliament questionnaire and are in the process of arranging calls for the groups of associations in late January, once responses to the European Parliament questionnaire have been filed.

Other activities: I spoke at a seminar organised by CEPS in Brussels on 16 November 2011, at which Maria Teresa Fabregas of DG Market and Diego Valiente of CEPS also spoke; I have presented our key concerns to members and like-minded associations in Copenhagen (joint with ISDA, hosted by the Danish securities dealers), Luxembourg, Madrid, Milan, Lugano, Stockholm and to ICMA's Committee of Regional Representatives (CRR). I have also attended briefing and discussion sessions held by the UK authorities. We hosted a lunchtime talk from Kay Swinburne MEP on 12 October, at which she gave her views on how best to contribute to the European Parliament's work, among other things. Adam Jacobs (of ISDA) and I discussed our concerns on MiFID at a lunchtime briefing at ICMA on 17 November.

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MIFID Review

In the previous Newsletter, we described the expected content of the European Commission's proposals for revisions to the Markets in Financial Instruments Directive (MiFID). Readers may recall that the main areas we expected to be of interest to ICMA members included:

- market structure, in particular the effect on fixed income markets of a new category of "Organised Trading Facilities" (OTFs);
- new pre- and post-trade price transparency obligations for non-equity transactions; a new obligation for firms that act as "Systematic Internalisers" (SIs) in non-equity instruments to open up their quotes to all clients; and
- the impact on the international capital market of proposed restrictions on third country firms' access to markets in the EU.

The formal proposals were published on 20 October. As expected, there are two complementary pieces of legislation: a [Regulation \(MiFIR\)](#), which when adopted will automatically form part of Member States' law, and a [Directive \(MiFID II\)](#), which will need to be transposed into Member State law. Most of the areas of interest to ICMA are contained in MiFIR.

Organised Trading Facilities (OTFs) and OTC trading:

OTFs are defined as "any system or facility, which is not a regulated market (RM) or Multilateral Trading Facility (MTF), operated by an investment firm or a market operator, in which multiple third-party buying and selling interests in financial instruments are able to interact in the system in a way that results in a contract". Whilst the MiFIR proposal envisages the continuity of OTC business, the legislation is clearly aimed at ensuring that as much trading as possible, in non-equity as well as equity markets, is carried out on RMs, MTFs, or OTFs.

Under the proposals, an OTF would not be able to transact business by committing its own capital. We will be seeking to reverse this prohibition, so as to minimise disruption for users of existing facilities. We will also aim to keep both the OTF definition and the OTC category broad enough to meet clients' needs.

Pre- and post-trade transparency: Pre-trade transparency on RMs, MTFs, and OTFs, and post-trade reporting to the market of all trades, would apply to all bonds and structured finance products admitted to trading on a RM or for which a prospectus has been published, and to derivatives trading on a MTF or OTF.

RMs, MTFs and OTFs would need to "make public prices and the depth of trading interests at those prices for orders or quotes advertised through their systems... [including] actionable indications of interest... on a continuous basis during normal trading hours". Access to the information would need to be on reasonable commercial terms and on a non-



In brief

This article identifies the main areas of interest to ICMA members in the European Commission's proposals for revisions to MiFID, and describes ICMA's work with members and others to address concerns.

discriminatory basis. Waivers are provided for, based on type and size of orders and method of trading. Details of the obligations and of waivers are deferred to Level 2 legislation, which is to be drafted after MiFID II and MiFIR are finalised.

RTs, MTFs, OTFs, and investment firms would need to publish the price, volume, and time of executed transactions, again on reasonable commercial terms and a non-discriminatory basis. Deferred publication is provided for, based on type or size of transaction, or type of bond. Details of the obligations and circumstances for delayed publication are deferred to Level 2 legislation.

We are exploring with members: how the pre- and post-trade requirements as drafted fit with the needs of clients; what amendments might be needed to adapt the legislation to the range of existing pre-trade transparency methods in the international capital market; and whether we should, even at this stage, develop models for the Level 2 provisions, with a view to advising the European Commission and other EU authorities on how the new market transparency regime needs to be fine-tuned to the needs of market users.

Important background on the issues associated with bond market transparency is in the CFA Institute's recent report, *An Examination of Transparency in European Bond Markets*. It concludes that post-trade transparency requirements should be calibrated to take account of the size and liquidity of the issue; that new requirements should be implemented gradually to allow market participants time to adapt trading processes; but that technological advances in the market lessen the need for mandated pre-trade transparency.

Systematic Internalisers (SIs): SIs (firms which, on an organised, frequent, and systematic basis deal on own account to execute client orders outside a RT, MTF or OTF) in bonds, structured products and derivatives would, when responding to a client's request for a quote, also be required to provide the quote to other clients, and deal against it with them up to a size which is to be determined in later Level 2 legislation.

These requirements partly replicate the existing SI requirements for equities, but are also more stringent in not applying a filter based on the liquidity of the

relevant instrument, and in not exempting firms that deal in this way only above a specified "standard market size". We are exploring with members what amendments may be needed to protect the interests of users of the international capital market, and whether we should also develop models for the associated Level 2 measures.

Third country firms: Third country firms without an establishment in the EU that deal with "eligible counterparties" (authorised financial institutions, national governments, central banks, supranational organisations, and large corporates) would be required to register with ESMA, and avoid providing services to other clients in the EU (being required to do so through an authorised branch). ESMA registration would be subject to a number of conditions, including a judgement by the European Commission that the regulation of the relevant third country was "equivalent" to the EU's, and that the third country provided reciprocal recognition of the prudential framework for EU firms. A transitional period of four years is allowed for.

Given the significant potential for such restrictions on third country firms' access to EU markets to disrupt the smooth operation of the international capital market, we are exploring with members what amendments are necessary to protect the role of, and worldwide participants in, European capital markets.

Next steps: The Council Working Group is expected to start negotiating the text in earnest in the New Year. Meanwhile, the European Parliament rapporteur, Markus Ferber, has issued a consultation questionnaire, to which ICMA will respond in January; Mr. Ferber is expected to propose amendments for the Parliament's Economic and Monetary Affairs Committee in February or March.

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by **Lalitha Colaco-Henry**

Short selling

It was [announced](#) in mid-October 2011 that the European Parliament, Council and Commission in trilogue had come to an agreement on new rules for Short Selling and Credit Default Swaps (CDS). The [draft Regulation](#) has now been adopted by the European Parliament and it is expected that the Council will adopt the text shortly. The Regulation is expected to enter into force in November this year, by which time the Commission's delegated acts and implementing and regulatory technical standards of ESMA will also need to have been adopted. The draft Regulation contains provisions in three areas – transparency, restrictions on naked short selling and regulatory powers.

Transparency of net short positions: A person with a net short position in shares admitted to trading on a trading venue (ie a regulated market or a multilateral trading facility in the EU) must notify the relevant competent authority whenever the position reaches or falls below 0.2% of the issued share capital and each 0.1% above that (Article 5). If the net short position reaches or falls below the publication threshold (0.5% of the issued share capital of the company and each 0.1% above that) the person must additionally disclose details of that position to the public (Article 7).

A person with a net short position in sovereign debt or CDS must notify the relevant competent authority whenever the position reaches or falls below the notification threshold. ESMA is required to specify the thresholds taking into account: (1) the total amount of outstanding issued sovereign debt for each sovereign issuer and the average size of positions held by market participants relating to that sovereign debt; and (2) the liquidity of each sovereign bond market (Article 8).

Restriction on uncovered short sales: A person may only enter into a short sale of shares if they have borrowed the shares, entered into an agreement to borrow the shares or entered into an arrangement with a third party under which the third party has confirmed that the shares have been located and measures have been taken for the short seller to have reasonable expectation that settlement can be effected when due (Article 12).

Similarly a person may only enter into a short sale of sovereign debt if they have borrowed the instruments or entered into an agreement to borrow them. However, the locate rule in respect of sovereign debt differs from the provisions relating to shares in that the third party either has to confirm that the sovereign debt has been located or has a reasonable expectation that settlement can be effected when due (Article 12a). Recital 16b sets out that a short sale covered by the purchase of sovereign debt in the same day is an example of a reasonable expectation that settlement can be effected when due.

The restriction on short sales of sovereign debt does not apply to transactions that hedge a long position in the debt instruments of an issuer, the pricing of which has a high correlation with the pricing of the given sovereign debt. It will also be possible for a competent authority to suspend the restriction temporarily for six months if the liquidity of the sovereign debt falls below a certain threshold. Such a suspension can be renewed for further periods.



In brief

This article provides a brief summary of the draft Regulation on Short Selling and certain aspects of Credit Default Swaps which was agreed by the European Parliament, Council and Commission in trilogue and which has subsequently been adopted by the Parliament.

Exemption	Provisions that do not apply
Shares of a company admitted to trading on an EU trading venue where the principal trading venue is located outside the EU.	Notifications regarding short sales of shares to regulators and the public (Article 5 & 7) Ban on naked shorts in shares (Article 12) Buy-in provisions (Article 13)
Market making transactions – when an investment firm/credit institution deals as principal in a financial instrument: (a) posting firm, simultaneous two-way quotes of comparable size and at competitive prices, with the result of providing liquidity on a regular and on-going basis to the market; (b) fulfilling orders initiated by clients or in response to clients' requests to trade, as part of its usual business (c) hedging positions arising from (a) and (b)	Notifications regarding short sales of shares to regulators and the public (Article 5 & 7) Notifications regarding shorts sales of sovereign debt & CDS (Article 8) Ban on naked shorts in shares (Article 12) Ban on naked shorts in sovereign debt (Article 12a) Ban on naked shorts in CDS (Article 12b)
The activities of a person, acting as an authorised primary dealer pursuant to an agreement with a sovereign issuer, when dealing as principal in a financial instrument in relation to primary or secondary market operations relating to that sovereign debt	Notifications regarding short sales of sovereign debt & CDS (Article 8) Ban on naked shorts in shares (Article 12) Ban on naked shorts in sovereign debt (Article 12a)
a person entering into a short sale or having a net short position in relation to the carrying out of a stabilisation transaction under MAD	Notifications regarding short sales of shares to regulators and the public (Article 5 & 7) Ban on naked shorts in shares (Article 12) Ban on naked shorts in sovereign debt (Article 12a) Ban on naked shorts in CDS (Article 12b)

Short sale: The draft Regulation defines a short sale as any sale of shares or debt instruments which the seller does not own at the time of entering into the agreement to sell, including such a sale where at the time of entering into the agreement to sell the seller has borrowed or agreed to borrow the share or debt instrument for delivery at settlement. The definition does not include a sale under a repo agreement, a securities lending agreement or a futures or other derivative contract where it is agreed to sell securities at a specified price at a future date.

Competent authorities may similarly suspend the restriction on the naked short selling of CDS though there is no analogous provision in respect of shares.

Buy-in procedures: A central counterparty providing clearing services for shares must have the following procedures:

- (1) where a person who sells shares is unable to deliver them within four business days after the day on which settlement is due, then procedures are automatically triggered for the buy-in of the shares;
- (2) where the buy-in of the shares is not possible then an amount is paid to the buyer based on the value of the shares to be delivered at the delivery date plus an amount for losses incurred by the buyer as a result of the settlement failure;
- (3) the seller must reimburse all amounts paid pursuant to points (1) and (2) – payments are to be made daily for each day the fail continues and are to be sufficiently high as to act as a deterrent.

There are a number of other points to note:

- Recital 7 sets out that disclosure of short sales of sovereign debt should only extend to regulators as public disclosure could have a detrimental effect on sovereign debt markets where liquidity is already impaired.
- Recital 17 provides that measures relating to sovereign debt and sovereign CDS should impose requirements which are proportionate and at the same time avoid an adverse impact on the liquidity of sovereign bond repo markets.
- Recital 15a provides that the definition of a short sale is not intended to include a repo agreement, a securities lending agreement or a derivative contract where it is agreed to sell securities at a specified price at a future date.
- Recital 16e notes that while the buy-in requirements should set basic standards relating to settlement discipline, it is essential to address wider aspects of settlement discipline in a horizontal legislative proposal to ensure the proper functioning of financial markets.

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by Nathalie Aubry-Stacey

The ICMA Asset Management and Investors Council – four years on

Since its first meeting in March 2008 in Zurich, the ICMA Asset Management and Investors Council (AMIC) has significantly changed. Its composition has broadened – representing not only asset managers but also investors – and the range of issues which it addresses has increased. Many exciting projects are coming to fruition thanks also to the establishment of permanent subsets of the AMIC – namely the ICMA Covered Bond Investor Council and the Private Banking Working Group – in addition to *ad hoc* working groups.

In the first four years of its existence, the AMIC has led many high-profile projects, ranging from responses to regulatory initiatives on corporate governance to “own initiative” reports on managing clients’ expectations. In addition, the AMIC has been in consultation with a wide range of national and European regulatory bodies.

The growth of the AMIC over the past four years underlines the need for such a forum to address and promote in a coordinated and systematic way the market issues of the buy side – which is structurally more fragmented than the sell side of the industry.

A new organisational structure has now been agreed by the AMIC to meet the needs of current and prospective AMIC members to remain independent from the representation of the sell side of the industry, as well as being transparent and efficient. The new structure is seen as a natural evolution of the AMIC in the context of incremental regulatory and market challenges. It will be based on three pillars:

- *The Asset Management and Investors Council:* The Council will discuss priorities of the Executive Committee – as defined below – and its work programme as well as general topics of interest to the buy side. The Council is expected to host a conference twice a year. One of two conferences will be held alongside the ICMA AGM. The first Council meeting is expected to take place alongside the ICMA AGM in Milan in May.
- *The Asset Management and Investors Executive Committee:* The Executive Committee will effectively be the executive arm of the Council and comprises a subset of Council members. The Executive Committee will take account of the views of the Council and be responsible for the “public output”

of the AMIC – for example, opinions on regulatory and market practice developments and responses to consultation papers.

- *The AMIC working groups:* These are core to the AMIC. The AMIC has already set up a number of working groups following requests from its members (on money market funds, managing clients’ expectations, corporate governance and exchange-traded funds). Other working groups have been set up to respond to market needs (CBIC and private banking). Working groups are made up of members of AMIC – involving both ICMA and AMIC-only members. External experts may also be invited to join the working groups (eg KPMG has been involved in the AMIC work on valuation of illiquid assets).

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Solvency II: impact on asset managers

The Solvency II Directive aims at harmonising and strengthening regulation in the European insurance field (see box). The Directive is planned to come into force in 2014. Insurance companies have already studied Pillars 1 and 2, looking respectively at the quantitative requirements and the supervisory review. The recently announced new deadline will now allow insurance companies to work more specifically on Pillar 3, which focuses on reporting and public disclosure.

The Directive will not directly affect the asset management industry. However, the industry has a key role to play, especially because of the asset data reporting requirements. Indeed, the reporting volume will dramatically increase, and be more detailed, complex and reported more frequently. The Directive will therefore have a big impact on investment managers' data systems.

This is why, under the impetus of some AMIC members, a specific working group dedicated to Solvency II and its impact on services delivered by asset managers to their clients has been established.

- One part of the project is to agree on some general principles at industry level regarding acceptable disclosure policies in terms of frequency and the timeline of reporting after the month and quarter end.
- The other relates to simplifying the "look through" into underlying fund holdings.

Here the idea is to explore the possibility of considering a set of Solvency II compliant risk numbers, whilst taking into consideration the reporting burden for a fund with very large portfolio holdings.

The Solvency II Directive (2009/138/EC) is an EU Directive that codifies and harmonises EU insurance regulation. The Directive involves a fundamental review of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of EU-wide capital requirements and risk management standards that will replace the current solvency requirements.

Solvency rules stipulate the minimum amounts of financial resources that insurers and reinsurers must have in order to cover the risks to which they are exposed. Equally importantly, the rules also lay down the principles that should guide insurers' overall risk management so that they can better anticipate any adverse events and better handle such situations.

The rationale for EU insurance legislation is to facilitate the development of a Single Market in insurance services, whilst at the same time securing an adequate level of consumer protection. The third-generation Insurance Directives established an "EU passport" (single licence) for insurers based on the concept of minimum harmonisation and mutual recognition. Many Member States have concluded that the current EU minimum requirements are not sufficient and have implemented their own reforms, thus leading to a situation where there is a patchwork

of regulatory requirements across the EU. This hampers the functioning of the Single Market.

The new Solvency II rules will replace these old requirements and establish more harmonised requirements across the EU, thus promoting competitive equality as well as high and more uniform levels of consumer protection.

- Since Solvency I (73/239/EEC) was introduced in 1973, more elaborate risk management systems have developed. Solvency II reflects new risk management practices to define required capital and manage risk. Solvency II has a much wider scope than Solvency I.
- Solvency II is somewhat similar to the banking regulations of Basel II. For example, the proposed Solvency II framework has three main pillars:
- Pillar 1 consists of the quantitative requirements (for example, the amount of capital an insurer should hold).
- Pillar 2 sets out requirements for the governance and risk management of insurers, as well as for the effective supervision of insurers.
- Pillar 3 focuses on disclosure and transparency requirements.

Given the lack of clarity in the reporting requirements, an asset management industry approach would help coordinate efforts with other industry groups affected by the changes in Solvency II.

The Working Group has a time horizon of two years, as the deadline has been recently postponed. The timing is appropriate as further clarification is currently being drafted by regulators.

The first meeting was organised on 19 October to gauge how much appetite there was amongst top asset managers to creating a Working Group and whether there was a real desire from the asset management industry to cooperate on a project that will span across the next two years. The reception was positive and other meetings have been organised to make progress on the project.

The Working Group is currently drafting a common response to the [EIOPA Consultation Paper](#) by the deadline of 20 January.

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Corporate governance

The AMIC has been very interested and engaged in the issue of shareholder participation for a couple of years now. AMIC members believe that there is a need for an effective corporate governance framework – as explained in its [response to the European Commission Green Paper](#), particularly one based on the premise of “comply or explain”. Institutional investors have been criticised for not exercising their responsibilities as shareholders and failing to hold boards to account for their activities. Regulators have called upon institutional investors to be more proactive in engaging with the management of companies. The need for the industry to improve in this

area has been recognised by the AMIC. Council members believe that it is good practice to be transparent (and publish voting records, for instance) and to ensure that clients are made aware of certain issues to be voted on. The European Commission has now published its [Feedback Statement](#).

The AMIC took the opportunity to respond to [the Kay review of UK Equity Markets and Long-Term Decision-Making](#). The review, which is independent, is due to examine investment in UK equity markets and its impact on the long-term performance and governance of UK quoted companies. The review's principal focus will be to ask how well equity markets are achieving their core purposes: to enhance the performance of UK companies by facilitating investment and enabling effective governance and decision-making in support of long-term profitability and growth; and to enable investors to benefit from this corporate activity in the form of returns from equity investment.

AMIC members responded to the questions affecting them. They presented their investment decision-making processes as well as appraisal procedures; their views on the functioning of the UK equity market, and the regulatory developments that affect the ability to invest according to a long-term horizon. Whilst being engaged is part of the commitment when taking a stake in a company, it is important to emphasise that asset managers are not the ultimate owners of the assets. Any regulation trying to regulate the agents as a proxy for encouraging desired behaviour by principals may be counterproductive, as agents have a fiduciary role and can only act on behalf of their clients as contractually agreed. If principals decline to empower agents, or go further and positively instruct them not to act, agents have no authority to follow regulators' instructions to do otherwise.

The UK Financial Reporting Council (FRC) published at the end of December [its first analysis of how the two codes under its supervision are being implemented](#) – the UK Corporate Governance Code for listed companies, revised in 2010, and the UK Stewardship Code for investors, launched in the same year. The report reveals the high level of take-up of the new provisions announced last year. For example, 80% of FTSE 350 boards have put all their directors up for annual re-election, demonstrating the value of the UK Corporate Governance Code in promoting behavioural change in the boardroom. The report highlights evidence that the quality of engagement between investors and company boards is improving in certain areas, for example in discussions around corporate risk.

The EU corporate governance framework is currently being discussed by various European Parliament Committees.

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Covered bond transparency

The ICMA Covered Bond Investor Council (CBIC) has started [its second round of consultation](#), focusing on the different themes identified as key in the consultation: investors; needs and additional fields; clarification of definitions and concepts; and format, frequency and access to the data.

A conference call between CBIC members highlighted some of the key elements of the transparency project going forward. Some important basic points were agreed:

- The information should be freely available for all investors.
- It must be presented in an Excel sheet format.

- Data should be reported on a half-yearly basis and shortly after issuers' results are published.
- The CBIC through the ICMA owns the template. ICMA is to draft appropriate disclaimers.
- The issuers will post a link to the CBIC European transparency standards webpage – and can add or remove the link, should they want to.
- This link must give access to the CBIC template with information provided by the issuer. Issuers are responsible for the information posted. Issuers may also wish to consider giving access to additional information to investors through the link.

The Council agreed as well that only issuers using the CBIC template will be allowed to post on the dedicated webpage – to ensure standardisation and comparability of the data received. CBIC members recognise that this could generate an additional administrative burden for issuers, but think this step is key to European standardisation, would be a great advantage for the European covered bond market and would eventually lower funding costs.

The CBIC has also started looking in detail at the feedback from national issuer associations, and providing high-level guidelines. General points regarding the CBIC expectations as regards the template and detailed responses to issuers' questions have been published on [the CBIC webpages](#). The CBIC has postponed the publication of its

final template to ensure all parties are adequately consulted and have a chance to raise their concerns.

However, the responses provided on the CBIC webpages will provide a good idea of the changes that will be made to the template.

In addition to the feedback received during its first consultation period, the CBIC has received the [response from the German Pfandbrief Banks Association \(the VdP\) explaining the legislative amendments to Article 28 of the Pfandbrief Act they will propose in response to the CBIC European transparency standards](#). They will add information about interest rate and currency risk to Article 287, the weighted average seasoning of real estate loans in the cover pool and the share of ECB eligible cover assets should be disclosed within the Article 28 reports.

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ESMA's technical advice on AIFMD Level 2

In the past few months the European Securities and Market Authority (ESMA) has consulted extensively on its technical advice which will form the substance of the secondary rulemaking to be adopted by the European Commission. These detailed rules will complement and render operational the higher level principles present in the Alternative Investment Fund Managers Directive (AIFMD).

ESMA delivered its [Final Report to the Commission on 16 November 2011](#).

The Commission will now transform the policy advice into legislation.

ESMA's advice covers four broad areas:

- *General provisions for managers, authorisation and operating conditions:* ESMA's advice is covered in sections III and IV (pages 16 to 135). ESMA seeks to clarify the operation of the thresholds that determine whether a manager is subject to the Directive. ESMA proposes to require alternative investment fund managers (AIFMs) to have additional own funds and/or professional indemnity insurance to cover risks arising from professional negligence. ESMA states that many of the rules in this section, such as conflict of interest, record keeping and organisational requirements, are based on the equivalent provisions of the UCITS Directive and the Markets in Financial Instruments Directive.
- *Governance of alternative investment funds' (AIFs) depositaries:* ESMA's advice is covered in section V (pages 136 to 187). Key issues include the criteria for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country has the same effect as the provisions of the Directive. ESMA refers to a number of criteria for this purpose, such as the independence of the relevant authority and the requirement on eligibility of entities wishing to act as depositary. An important point is the liability of depositaries, the first element of which relates to the circumstances

in which a financial instrument held in custody should be considered as “lost”. This assessment is crucial in determining whether a depositary must subsequently return an asset. ESMA’s advice proposes three conditions, at least one of which would have to be fulfilled in order for an asset to be considered lost. These are that: a stated right of ownership of the AIF is discovered to be unfounded because it either ceases to exist or never existed; the AIF has been permanently deprived of its right of ownership over the financial instruments; or the AIF is permanently unable directly or indirectly to dispose of the financial instruments. Another important concept that ESMA seeks to clarify relates to which events would constitute external events beyond the reasonable control of the depositary.

- *Transparency requirements and leverage:* ESMA’s advice is covered in sections VI to VIII (pages 188 to 239). ESMA seeks to clarify the definition of leverage, how it should be calculated and in what circumstances a competent authority should be able to impose limits on the leverage a particular AIFM may employ. ESMA prescribes two different calculation methodologies for leverage (commitment and gross methods) as well as a further option (the advanced method) that can be used by managers on request and subject to certain criteria. In relation to transparency, ESMA’s advice also specifies the form and content of information to be reported to competent authorities and investors, as well as the information to be included in the annual report.

- *Third countries:* ESMA’s advice is covered in section IX (pages 240 to 246). ESMA seeks to put in place a framework regarding supervisory cooperation and exchange of information. ESMA envisages that the arrangements between EU and non-EU authorities should take the form of written agreements allowing for the exchange of information for both supervisory and enforcement purposes.

Although the final ESMA report has improved from its initial draft in a great number of areas (third countries, depositaries’ operational obligations, own funds, delegation, transparency and reporting), serious concerns remain as regards such issues as the depositary liability for lost assets, definition of leverage, powers of competent authorities to limit leverage and the definition of the valuation function. The AMIC will continue to be engaged with the relevant market stakeholders throughout the next steps of the legislative process.

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Collateral – an area of special focus for 2012 and beyond

The importance of collateral has grown over many years, but has accelerated significantly since the advent of the financial crisis in mid-2007. This is in no small measure related to the shift in risk appetite of market participants, with an increased demand amongst them to secure their credit risk exposures through the taking of high quality collateral. Official policy makers have also significantly fuelled the demand for collateral as they have advanced steps to make markets more robust, to reduce systemic risk and help mitigate the risks of any future financial crises. Amongst examples of these increasing demands are:

- increased focus on covered bond issuance by banks, secured against high-quality mortgage pools, as against senior unsecured issuance;
- increased use of repo funding to finance assets, including in context of an increase in the use of central bank financing;
- Basel requirements, to be translated in the EU through the CRR/D; introducing the holding of liquidity stress buffers – assets to satisfy these requirements comprise a short list of high-quality collateral;
- the shift of standardised OTC derivatives to CCP clearing, as required in the EU by EMIR, which will give rise to demands for significant amounts of initial margin (as well as some increase in variation margin amounts); and
- increased requirements to margin any bilateral OTC contracts (outside of CCP arrangements), incentivised by penal treatment of uncollateralised exposures in the CRR/D requirements.

Whilst these examples are couched in their European context, equivalent pressures also exist across global markets.

It is widely perceived that collateral demands will significantly outstrip supply, so it is essential that collateral be managed as a scarce resource. Given the competing demands that exist for the use of collateral assets, the management of collateral needs to encompass the deployment of optimisation techniques – to ensure that the available collateral is utilised as effectively and efficiently as possible.

The industry is already exploring to what extent regulatory pressures may be mitigated through the acceptance of a broader range of collateral assets. For instance, assets such as gold, equities and high-grade corporate debt may have a role to play alongside other already favoured collateral assets – cash, government bonds and covered bonds. Similar debates are also pertinent in context of collateral for private contracts, where another alternative under discussion is the utilisation of credit claims (loans) as repo collateral, in lieu of the use of the hitherto favoured bond obligations (securities). Other potential efficiencies being pursued include:

- harmonisation of requirements, for example so that central banks adopt uniform repo collateral pools; or so that each country accepts the same set of assets for liquidity buffer holdings rather than its own tailored set;
- interoperability amongst market actors to avoid fragmentation of liquidity pools; and
- usage of various forms of collateral swaps, so as better to match collateral sources to collateral uses.

However, each of these possible refinements comes with its own potential drawbacks, and public authorities understandably challenge the extent to which such refinements may be utilised.

The various public authorities are playing a significant part in influencing the changes to the environment for collateral. A large part of this stems from their role

in designing the new rules (EMIR, CRR/D, etc), but they are also responsible for certain directly relevant infrastructure projects, particularly including the ECB's collateral central bank management (CCBM2) and TARGET 2 Securities (T2S). As reviewed in the infrastructure section of this Quarterly Report, at the 18 November meeting of the ECB's COGESI, the agenda included a discussion on "Collateral issues". Effective industry engagement with these efforts will be essential to help ensure they prove truly fruitful and are coherent with the various associated initiatives which are already being invested in across the financial industry.

At this important juncture, ICMA considers there is a valuable opportunity to establish joint efforts to ensure that all collateral-related initiatives can be appropriately coordinated. This should include identification of any synergies, including opportunities to leverage efforts and experience. In the private sector ICMA is already seeking to achieve that by making available the necessary dedicated time from its staff to provide secretariat support to make possible a Collateral Initiatives Coordination Forum. This will be chaired by Godfried De Vidts and engage a wide range of industry trade associations with interests in the broad topic of collateral. An initial meeting of this Forum, which will *inter alia* aim to agree the Forum's terms of reference, is planned for the end of January. An important measure of the success of the Forum will be ensuring that its work can effectively be channelled into applicable official sector projects.

It should be recognised by everyone that a comprehensive and all-inclusive effort will be needed to optimise the use of collateral.

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Market infrastructure developments

European Commission: Expert Group on Market Infrastructures

The European Commission held a conference on 24 October in Brussels to discuss [the road ahead](#) for the European post-trading landscape. This was organised to follow the 13 October publication of [the report](#) of the Expert Group on Market Infrastructures (EGMI). After the opening address given by Jonathan Faull, Director General DG Markt, the conference comprised three panel sessions covering safety; efficiency; and competition. There was also a speech from Professor Alberto Giovannini and a closing statement given by Nadia Calviño, Deputy Director General DG Markt.

European Commission: European Market Infrastructure Regulation (EMIR)

Published on 15 September, the Commission's EMIR proposal is a Regulation on [OTC Derivatives, Central Counterparties and Trade Repositories](#). The aim is that, in line with G20 commitments, the new rules should be fully in place and operational by the end of 2012. The Commission, together with the Council and the Parliament, have been striving to conclude trilogue discussions. Sticking points concern certain issues regarding EMIR's interaction with third country regimes; and some aspects of the split of responsibilities between ESMA and national supervisory authorities. The latest target is to present an agreed package for sign-off at the ECOFIN meeting in late January.

ECB: Contact Group on Euro Securities Infrastructures

On 18 November, [the ECB hosted](#) the latest meeting of its Contact Group on Euro Securities Infrastructures (COGESI). Following a review of latest developments, the meeting included discussions on the role of central and commercial bank money in European clearing and settlement; and on interoperability of ICSD triparty services. Both of these discussions were based on recent work by ICMA's ERC. There were then reports relating to the work of EGMI and that of CPSS-IOSCO; and a discussion concerning legislative process in the EU.

The final topic covered by the meeting was collateral issues. The Eurosystem has started a broader reflection on harmonisation of collateral procedures and is considering linking the harmonisation of procedures on the collateral management side to the CCBM2 initiative. It is considered that work should start during 2012 and that there are a number of topics that could benefit from harmonisation, eg:

- harmonisation of collateral procedures (including central bank practices);
- interoperability of (triparty) collateral management services (for repo markets);
- harmonisation of procedures for non-marketable assets (eg credit claims and their possible use on secondary markets);
- facilities for un-collateralised money markets;
- facilities involving foreign collateral (eg as part of collateral pools, central bank services, or CCPs' arrangements and their use of cash as collateral); and arrangements for transformation of collateral.

Work should include input from both COGESI members and the European Commission. (Subsequently, ICMA and the ERC's Chairman have collectively notified the Eurosystem of their support and of their desire to be closely involved in this work). It has been clarified that the future work will not affect some of the previously announced enhancements of the Eurosystem, such as the removal of the repatriation requirement and the cross-border triparty collateral management services, both of which are foreseen for implementation in 2014 at the latest

ECB: Money Market Contact Group

On 14 December, the ECB [hosted the latest meeting](#) of its Money Market Contact Group (MMCG). The meeting included an overview of changes to the liquidity management of an investment bank; a review of the main findings of the latest major money market surveys (the ECB Money Market Survey and the ICMA Repo Market Survey); an update on the most recent repo market developments; and a review the latest developments in the euro money market.

ECB: TARGET2-Securities

On 20 October 2011, the [Governing Council of the ECB decided](#) that TARGET2-Securities (T2S) would go live nine months later than planned – ie in June 2015, rather than September 2014. The Governing Council also decided to extend the deadline for the signing of the Framework Agreement. This revised “go live” date was based on a proposal by the T2S Programme Board that had reviewed the programme plan upon a request by the market to implement a number of changes to the T2S user requirements. The Programme Board’s review of the plan also identified a number of additional points that imposed time constraints on the current plan. It has also been agreed that CSDs in the first migration wave will be invited to participate in an additional pilot test, besides the already foreseen user testing.

Prepared in close cooperation with the market, the T2S [User Detailed Functional Specifications](#) version 1.2, which was [released on 31 October](#), is a major milestone in the T2S programme plan. It illustrates features of T2S from a business perspective, provides details about application-to-application dialogue between T2S actors and T2S and gives a detailed description of the set of messages processed by T2S. CSDs and national central banks can consider this version as the stable basis for their feasibility assessments for adapting to T2S; and it can be used by other directly connected T2S actors to design and build the interface of their information systems with T2S. At the same time, the T2S Programme Board shared the first version of the [Dedicated Links Connectivity Specifications](#) with the market.

In its [17 November 2011 meeting](#), the Governing Council endorsed the [T2S Framework Agreement](#) (FA) and the related schedules. This agreement sets out the contractual rights and obligations of the Eurosystem and each contracting CSD; and covers the development and operation of T2S. On 22 November 2011, the President of the ECB transmitted the FA to all of the CSDs that have participated in the negotiations over the past two years, formally inviting them to sign it by 30 April. If CSDs require more time to complete their feasibility study, it is also possible to sign the Agreement by 30 June.

On 29 November, a [new issue of T2S OnLine](#) was published by the ECB. In this the Chairman of the T2S Programme Board discusses the FA; and he confirms that the decision by the Bank of England and the Swiss National Bank, not to participate in T2S with their currencies, does not affect the existing price commitment. The T2S project update includes details of the incentive package designed to encourage the CSDs to sign the FA promptly. In the *Insight* there are articles by Alberto Giovannini, on the impact of the crisis and EU regulation on the market infrastructure, and by Stephan Sauer, on the future T2S governance. *Bayle’s View* examines the key T2S technical building blocks; and how the parties’ contractual rights and obligations are defined.

From 4-5 October 2011, a [conference was held](#) in Frankfurt, under the title of *Securities Settlement in 2020: T2S and Beyond*. This considered what the securities settlement industry will look like in 2020, contemplating changes triggered both by T2S and by other factors, such as globalisation. A T2S info session was [held on 25 October](#) 2011 in Tallinn and another [on 21 December](#) 2011 in Stockholm. The Advisory Group (AG), which is an advisory body that reports directly to the ECB’s decision-making bodies on the T2S project, last [met on 30 November](#) 2011 (and next meets on 27 March).

Global Legal Entity Identification numbers

In December 2011, the International Organization for Standardization (ISO) unanimously endorsed the industry’s recommendation for new ISO standard “ISO 17442” to be used as the standard for a global Legal Entity Identifier (LEI) solution.

Additionally, the US Commodity Futures Trading Commission (CFTC) gave notice of its final rulemaking on [Swap Data Recordkeeping and Reporting Requirements](#). One element of this rulemaking is the required use of unique identifiers in swap (ie derivatives) data recordkeeping and reporting. This includes requirements for the use of LEIs, alongside required use of unique swap identifiers and unique product identifiers. The required LEIs must be issued under, and conform to, ISO 17442.

There are quite a number of LEI resources readily available on the internet, for example through the GFMA’s [LEI “Resources” page](#).

diary

LinkedIn

There is an active ICMA page and discussion group on [LinkedIn](#) (search International Capital Market Association), where we post information about news and events. We have just started an Education subgroup for alumni of our Executive Education courses.

18 JAN

ICMA European Repo Council (ERC) Annual General Meeting, Luxembourg, 18 January

The 2012 ERC AGM will be held in Luxembourg in the margins of the Clearstream16th Global Securities Financing Summit.

The AGM is open to everyone in the European Repo Community.

[Register here](#)

19 JAN

Les Rencontres des Professionnels des Marchés de la Dette et du Change, Paris, 19 January

Organised by ICMA France and associations of Fixed Income Professionals. Featuring panels on: What Future for Securitisation?; The evolution of asset management and regulation; European Infrastructures and Paris Market Place.

[Register here](#)

20-22 JAN

ICMA Annual Charity Ski Weekend, Engelberg, 20-22 January

Organised by the ICMA Switzerland and Liechtenstein region annually for more than 30 years, the ICMA ski weekend is a chance to compete and network with members from around the world.

This year's nominated charity is Gift2Help Limited.

[Register here](#)

24 JAN

4th Annual ICMA-NCMF Conference, Stockholm, 24 January Nordic and international capital markets – weathering the financial storm

ICMA and the Nordic Capital Markets Forum (NCMF) present the fourth annual conference on developments in Nordic and International capital markets. Expert panels will consider: the macroeconomic risk outlook for the Nordic region and Europe; the future of government and state sponsored financing in the new environment; continuing challenges for bank funding and changes to regulation.

[Register here](#)

ICMA organises over 100 market-related events each year attended by members and non-members. For full details see www.icmagroup.org

26 JAN

ACI and ICMA 2012 Economic Summit and New Year's Event, Brussels, 26 January

The evening economic summit is organised by the ICMA Belgium region and features four prominent economists from financial institutions who will provide a brief outlook for 2012 on the different financial markets followed by a panel discussion. The event, which includes a buffet dinner and entertainment, is open to all ICMA members.

[Register here](#)

01-03 FEB

***Global Master Agreement for Repo and Securities Lending Workshop, Madrid, 1-3 February**

The workshop will include a detailed review of the two legal agreements and their application, together with case studies. The operational and basic legal characteristics of the repo and securities lending markets will also be covered.

[Register here](#)

**Course/workshop accredited under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme*

10 MAY

**Covered Bond Investor Conference, Frankfurt, 10 May
SAVE THE DATE**

ICMA's Covered Bond Investor Council (CBIC) and The Covered Bond Report are launching their first joint conference, which will be held in Frankfurt on the 10 May.

[Pre-register for this event](#)

23-25 MAY

**ICMA AGM and Conference, Milan, 23-25 May
REGISTRATION WILL OPEN END OF JANUARY**

The 44th ICMA AGM and conference will be held at the Palazzo Mezzanotte in Milan. The ICMA AGM and Conference is a unique event, offering delegates informed insights into market developments and the regulatory landscape from acknowledged experts and market practitioners. It also offers many opportunities for building professional contacts in the cross border securities market.

[Contact the ICMA Events team for sponsorship opportunities at discounted rates for members.](#)

01 FEB

The Global Master Repurchase Agreement (GMRA) 2011 - roundtable briefing, Madrid, 1 February

The 2011 version of the GMRA, is the most widely used standard documentation for the cross-border repo market. The briefing on the GMRA 2011 will be led by Lisa Cleary, ICMA Associate Counsel.

[Register here](#)

16 MAR

***Understanding the ICMA Primary Market Handbook (IPMA Handbook), London, 16 March**

The half-day workshop will give an overview of the scope and application of the recommendations in the handbook and will also review recent developments and changes.

[Register here](#)

**Course/workshop accredited under the Solicitors Regulation Authority (formerly The Law Society's) CPD Scheme*

ICMA Executive Education in 2012

Register now for
these courses

The ICMA Executive Education offering already consists of 19 different courses at Introductory, Intermediate and Specialist level. In response to demand, three new specialist programmes will be held during 2012: 'Trading the Yield Curve with Interest Rate Derivatives', 'Trading and Hedging Short-Term Interest Rate Risk' and 'Fixed Income Portfolio Management'. We shall also be extending the range of international locations where we hold our public courses and for the first time will be adding venues in Dubai, Hong Kong and Malaysia. In Malaysia, the University of Reading is opening a new campus at Iskandar and we have scheduled a full week of securities courses to take place there in June.

The Education sub-group on [ICMA's LinkedIn page](#) is another useful way in which you can find out about latest developments to our Executive Education Programme.

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Introductory Programmes

Financial Markets Foundation Course (FMFC)

Luxembourg: 5-7 March 2012
London: 29-31 May 2012
Luxembourg: 24-26 September 2012
London: 19-21 November 2012

Securities Operations Foundation Course (SOFC)

London: 25-27 January 2012
Brussels: 12-14 March 2012
Malaysia: 11-13 June 2012
London: 10-12 September 2012
Brussels: 12-14 November 2012

Intermediate Programmes

International Fixed Income and Derivatives (IFID) Certificate Programme

Next residential courses:
Sitges, Barcelona: 22-28 April 2012
Hong Kong: 24-30 June 2012
Sitges, Barcelona: 28 October – 3 November 2012

Operations Certificate Programme (OCP)

Brussels: 25-31 March 2012

Primary Market Certificate (PMC)

Dubai: 22-26 January 2012
in association with Thomson Reuters
London: 14-18 May 2012
London: 19-23 November 2012

Specialist Programmes

See website for details

Collateral Management

London: 8-9 March 2012

Commodities - An Introduction

London: 29 March 2012

Commodities - Trading and Investment Strategies

London: 30 March 2012

Securities Lending & Borrowing

London: 19-20 April 2012

Corporate Actions - Operational Challenges

London: 3-4 May 2012

Credit Default Swaps - Features, Pricing and Applications

London: 18-19 June 2012

Credit Default Swaps - Operations

London: 20 June 2012

Derivatives Operations

Malaysia: 14-15 June 2012

ICMA Executive Education – Skills Courses

Mastering Mandates,

London

Successful Sales

London

See www.icmagroup.org for full details

ABCP	Asset-Backed Commercial Paper
AIFMD	Alternative Investment Fund Managers Directive
AMF	Autorité des marchés financiers
AMIC	ICMA Asset Management and Investors Council
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
CAC	Collective action clause
CBIC	ICMA Covered Bond Investor Council
CCBM2	Collateral Central Bank Management
CCP	Central counterparty
CDS	Credit default swap
CoCo	Contingent convertible
CPSS	Committee of Payments and Securities Settlement
CRA	Credit rating agency
CRD	Capital Requirements Directive
CRR	Capital Requirements Regulation
CSD	Central Securities Depository
DMO	Debt Management Office
EBA	European Banking Authority
ECB	European Central Bank
ECOFIN	Economic and Financial Ministers (of the EU)
ECON	Economic and Monetary Affairs Committee of the European Parliament
ECP	Euro Commercial Paper
EEA	European Economic Area
EFAMA	European Fund and Asset Management Association
EFC	Economic and Financial Committee (of the EU)
EFSF	European Stability Facility
EGMI	European Group on Market Infrastructures
EMIR	European Market Infrastructure regulation
ERC	ICMA European Repo Council
ESMA	European Securities and Markets Authority
ESM	European Stability Mechanism
ESRB	European Systemic Risk Board
ETF	Exchange-traded fund

FPC	UK Financial Policy Committee
FSA	UK Financial Services Authority
FSB	Financial Stability Board
G20	Group of Twenty
GDP	Gross Domestic Product
GMRA	Global Master Repurchase Agreement
G-SIBs	Global systemically important banks
G-SIFIs	Global systemically important financial institutions
ICMA	International Capital Market Association
ICSA	International Council of Securities Associations
ICSDs	International Central Securities Depositories
IMMFA	International Money Market Funds Association
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISDA	International Swaps and Derivatives Association
ISLA	International Securities Lending Association
LCR	Liquidity Coverage Ratio (or Requirement)
MiFID	Markets in Financial Instruments Directive
MiFID II	Proposed revision of MiFID
MiFIR	Proposed Markets in Financial Instruments Regulation
MMF	Money market fund
MTF	Multilateral Trading Facility
NSFR	Net Stable Funding Ratio (or Requirement)
OTC	Over-the-counter
OTFs	Organised trading facilities
PRIPs	Packaged Retail Investment Products
RM	Regulated Market
RPC	ICMA Regulatory Policy Committee
SBWG	ICMA Sovereign Bonds Working Group
SGP	Stability and Growth Pact
SI	Systematic Internaliser
SMPC	ICMA Secondary Market Practices Committee
SRO	Self-regulatory organisation
T2S	TARGET2-Securities
TARGET	Trans-European Automated Real-Time Gross Settlement Express Transfer System



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

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