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ICMA in the international capital market

Foreword by René Karsenti, President, ICMA

In order to provide guidance to the Board of ICMA, when defining the Association's future strategy, the Board requested that the General Meeting of ICMA in Montreux on 4 June confirm that "ICMA shall continue and further develop its activities based on its current statutes". This proposal was approved by the General Meeting. The strategy recommended to ICMA members was based on extensive consultations earlier in the year with more than 150 members to whom I would like to extend my thanks for their availability and guidance.

Over the past 40 years, ICMA has made a significant contribution to the development of the international capital market. Since the beginning of the Euromarkets, ICMA has facilitated the interaction between issuers, lead managers, dealers and investors for the benefit of an efficient and well-functioning securities market. From its beginning as a modest offshore market, the international capital market has grown into a broad and deep market of around €10 trillion serving the needs of governments, supranationals and corporates from all over the world. From year to year, decade to decade, the market has expanded dynamically across all geographical and product areas, helping the free movement of capital across borders and the integration of economies, removing obstacles and building bridges linking the different national markets together, and enhancing structural reform and monetary integration.

ICMA in its activities has very often been the frontrunner in creating the framework of cross-border issuing, trading and investing, and has constantly helped to build the relationship amongst all market participants. As a self-regulatory and trade association, ICMA has initiated numerous sets of standard practices to help develop efficient and well-functioning markets. As a trade association, ICMA, through its research and educational activities, has increased the links between institutions from all over the world. ICMA has never understood itself as an advocacy or lobbying organisation, but as an association with the objective of finding practical solutions in the steadily changing political and economic financial framework. ICMA is and was always a strong voice in the promotion of free capital flows across borders and all other efforts on the long road to



René Karsenti

ICMA in the international capital market - continued

integrated capital and financial markets. In this effort, ICMA has been a partner of regulatory and other governmental/monetary institutions, helping them in the achievement of very ambitious objectives.

Promoting “best practices” and standards, contributing to education, helping supervisory authorities and furthering the links between its members, was and is ICMA's mission. For the benefit of all market participants, ICMA concentrates on “market questions and solutions”, not on the self-interests of any particular segment of financial institutions. It was in this spirit that ICMA developed a commercial activity, TRAX, which serves the market extremely well in data provision, until the activity was recently put into the professional hands of Euroclear, one of the market's most important infrastructure providers.

The dynamic development of the international capital market and accelerated globalisation has led to evermore complex markets with many new asset classes, which pose market-related, legal and practical challenges to market participants as well as supervisory and political authorities. The international market has therefore, on the one hand, seen many new trade associations active in particular segments of the market and, on the other hand, seen some consolidation among associations in other segments. In debt capital markets, ICMA continues to play a major role, particularly due to its unmatched geographical and institutional diversity. As a cross-border association, ICMA sponsors and brings together sell and buy side, works on the improvement of the legal framework and continues to see its mission to service the market as a whole.

ICMA concentrates its efforts on practical steps to try to make markets more efficient and safe, believing that such an approach will ensure constant improvements. It will continue to represent general market matters as a whole to the monetary and regulatory authorities who are vested with the responsibility to create the appropriate framework for a national and international financial system. ICMA sees itself operating as a partner to these bodies in stressing that self-regulation can help to solve problems more efficiently. It realises the complexities and difficulties, and sees itself only as one part of many organisations that have to cooperate in order to make progress towards a stable global market framework.

In this context ICMA will continue to reinforce its cooperation with other associations and respects the different orientation of other trade bodies. ICMA will carefully monitor developments in this area and envisages that, indeed, certain activities could be organised jointly among different associations. ICMA will cooperate and contribute financially to actions

which are of general interest to the market and therefore for the entire membership. ICMA is convinced that a cooperative model is in tune with the present state of the development of financial markets.

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Appointments of new Chief Executive and President



Martin Scheck

On 5 June, ICMA announced the appointments of Martin Scheck as Chief Executive and René Karsenti as President, effective 1 August. This combination strengthens ICMA's focus on the development of the standard market practices which are an essential part of creating more integrated capital markets.

Martin Scheck will lead ICMA's activities in promoting the development and efficient functioning of the international capital market. He has been a Board member of ICMA since 2004 and is the Chairman of its Audit, Compliance and Governance Committee. He joins the Association from UBS AG, Zurich, where he has been Managing Director and Head of Swiss Fixed Income since 2001.

René Karsenti, who has held the post of Executive President since May 2006, will become President of the Association, with primary responsibilities to represent ICMA's interest in its interaction with governments, regulatory bodies, other trade associations and international organisations together with Martin Scheck.

Hans-Joerg Rudloff, ICMA's Chairman, said: “These appointments represent a considerable strengthening of ICMA's executive management and enhance its services to its membership and the market. Martin Scheck has the skills and experience to deliver further improved operational efficiency. ICMA will also benefit further from René Karsenti's knowledge, expertise and established relationships.”

Making markets better and safer

One of the critical questions arising from the international financial crisis is how to make international securities markets work better and more safely in the future. The authorities in Europe are implementing a series of measures in an attempt to achieve this: regulating credit rating agencies (CRAs); requiring originators of securitisations to keep 5% “skin in the game” under the Capital Requirements Directives (CRD); clearing through central counterparties (CCPs); and improving transparency in the primary and secondary over-the-counter (OTC) markets. Similar measures are being considered elsewhere. It is clear that more attention will be given to the regulation of financial products in wholesale as well as retail markets, and that regulation of individual financial institutions will become more intrusive, in the period ahead than before the crisis.

But irrespective of the advantages and disadvantages of these individual measures, the real issue for ICMA and its members is what the securities markets can do themselves on behalf of

counterparties and customers. In practice they do a great deal already. Most markets have continued to function during the crisis, albeit subject to stress, and the infrastructure – clearing, settlement and legal documentation – underpinning market transactions has proved largely resilient so far.

What more can be done? The main criticisms of securities markets are that they are allegedly not sufficiently transparent, liquid and safe. On transparency, a large amount of information is already available to investors in OTC markets, and the position has improved since the crisis began. But questions remain about accessibility, comprehensiveness, timeliness and cost, particularly for smaller fund managers and for retail investors. A fundamental issue is whether more transparency, particularly if it is poorly calibrated, will damage liquidity.

On liquidity, OTC markets depend on a continuing commitment of capital by dealers to enable client trading decisions to be executed immediately. Without capital commitment, dealers can only search the market for counterparties: this can take hours, days or even weeks. The amount of risk capital that dealers have been willing to commit during the crisis has, not surprisingly, been significantly reduced. The question is whether



Panel on *Creating market stability and restoring orderly markets* at ICMA's recent conference in Montreux, with Daniel Zuberbühler, Vice-Chairman, Swiss Financial Market Supervisory Authority FINMA; Michael Ridley, Managing Director, JP Morgan Securities and Chairman, ICMA's Secondary Market Practices Committee; Francesco Papadia, Director General, Market Operations, European Central Bank; and Robert Gray, Chairman, Debt Financing and Advisory, HSBC, Vice Chairman, ICMA and Chairman, ICMA's Regulatory Policy Committee.

more capital will be committed as market conditions return to normal, so that illiquid securities become more readily tradable again and spreads are reduced.

On safety, there are a number of projects to make securities markets safer, such as central counterparty netting and straight-through-processing. But they are more relevant for standardised than bespoke financial products. In making securities markets safer, it is also important to preserve investor choice and the ability of intermediaries to innovate.

ICMA, both as a self-regulatory organisation and trade association, is playing a significant part in helping to make securities markets better and safer. We recognise that our members – as issuers, lead managers, dealers and investors – have a collective interest in the proper functioning of the securities markets as a whole (see box). And during the international financial crisis, we have enhanced our dialogue with regulators and officials, and involved the chairs and representatives of our committees of market experts so that they can provide a market perspective to the authorities.

Practical initiatives by ICMA

Legal helpdesk: ICMA provides guidance to members on its rules and recommendations for the primary and secondary market in international securities, as well as the Global Master Repurchase Agreement (GMRA) and the numerous opinions underpinning the GMRA.

Pre-sounding: ICMA's Primary Market Practices Committee has adopted a recommendation that, if a syndicated debt transaction is to be pre-sounded, the banks involved will discuss this in advance so as to help them, when facing "inside information" rules that are difficult to interpret, to agree a common position and so avoid confusion among those sounded as to the status of the information they receive.

Updating secondary market rules and recommendations: ICMA's Secondary Market Working Group has updated ICMA's rules and recommendations in the secondary market, with the changes becoming effective from the beginning of this year.

GMRA review: Feedback from members of the European Repo Committee on the functioning of the GMRA during the international financial crisis has confirmed the GMRA's quality and robustness. But members have highlighted two areas for review: the set-off clause and the valuation

mechanism on default. A working group has been established to discuss the extent and method of modification.

ABCP code of conduct: Through ICMA's Euro Commercial Paper Committee, the asset-backed commercial paper (ABCP) market has adopted a code of conduct on disclosure that is designed to ensure that investors in ABCP have timely access to relevant information.

Bond market transparency: ICMA's Regulatory Policy Committee has established, and is monitoring, a standard of good practice on bond market transparency to help retail investors; and ICMA is encouraging the sell side and the buy side to agree on a market-led initiative relating to transparency and liquidity in the wholesale market.

Managing client expectations: ICMA's Asset Management and Investors Council has drawn up guidelines to help fund managers better to assess client needs so as to avoid over-promising and under-delivering.

Timely provision of documentation: ICMA's Legal & Documentation Committee has issued guidance to the market on the provision of information and documents to intermediaries in a timely way, in the case of issues of securities held through the International Central Securities Depositories.

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European financial supervision

The European Commission has adopted a [Communication on Financial supervision in Europe](#), published on 27 May. This Communication builds on, and reflects the general support given to, the [de Larosière report](#) and the Commission's related [Communication of 4 March 2009](#). The aim of this initiative, which proposes a set of ambitious reforms to the current architecture of financial services supervision, is to respond to the weaknesses identified during the credit crisis as well as to the [G20 call](#) to "take action to build a stronger, more globally consistent, supervisory and regulatory framework for the future financial sector". The financial supervision package proposed in this Communication involves two key elements.

European Systemic Risk Board

The Commission proposes that the European Systemic Risk Council (now Board) (ESRB) should be established as a new independent body, responsible for safeguarding financial stability by conducting macro-prudential supervision at European level. In order to perform this role, it is proposed that the ESRB should:

- collect and analyse all information relevant for monitoring and assessing potential threats to financial stability that arise from macro-economic developments and developments within the financial system as a whole;
- identify and prioritise such risks;
- issue risk warnings where risks appear to be significant;
- where necessary, give recommendations on the measures to be taken in reaction to the risks identified;
- monitor the required follow-up to warnings and recommendations; and
- liaise effectively with the International Monetary Fund, the Financial Stability Board and third country counterparts.

It is foreseen that the ESRB will be composed of a combination of:

- members: the President of the European Central Bank (ECB) (Chair); Vice-Chair (elected by ESRB members); Governors of the 27 national central banks; Vice-President of the ECB; Chairs of the three European Supervisory Authorities; and a member of the European Commission; and

- observers: representatives of the national supervisory authorities, accompanying the central bank Governor in a 1+1 formula; and the Chair of the Economic and Financial Committee.

The creation of the ESRB seeks to address one of the fundamental weaknesses highlighted by this crisis, which is the exposure of the financial system to interconnected, complex, sectoral and cross-sectoral systemic risks.

European System of Financial Supervisors

The Commission proposes that the European System of Financial Supervisors (ESFS), for the supervision of individual financial institutions ("micro-prudential supervision"), should consist of a robust network of national financial supervisors working in tandem with new European Supervisory Authorities, created by the transformation of the three existing Committees for the banking, insurance and occupational pensions, and securities sectors. The fostering of harmonised rules and coherent supervisory practice and enforcement is to be a key aim. The new European Supervisory Authorities will take on all the missions of the current Committees of Supervisors (the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR)), but in addition have increased responsibilities, defined legal powers and greater authority.

More specifically, the Commission proposes that, to achieve the ESFS's objectives, the new European Supervisory Authorities will need to be equipped to fulfil the following functions:

- ensure a single set of harmonised EU rules;
- ensure consistent application of EU rules, either in case of disagreement between national supervisors or manifest breach of Community law;
- ensure a common supervisory culture and consistent supervisory practices;
- have full supervisory powers for some specific entities with pan-European reach: eg credit rating agencies and EU central counterparty clearing houses;
- ensure a coordinated response in crisis situations;
- collect micro-prudential information; and
- undertake an international role.

European financial supervision - continued

It is foreseen that the ESFS will be organised with three distinct, interacting levels:

- a Steering Committee, comprised of representatives of the three European Supervisory Authorities and the Commission;
- the three European Supervisory Authorities – the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA), and the European Securities Authority (ESA); and
- national supervisory authorities.

The EBA, EIOPA and ESA would each have:

- a Board of Supervisors: comprising the Chair of the respective European Supervisory Authority and Chairs from the appropriate national supervisory authorities; together with, as observers, a Commission representative, a representative of the ESRB and a representative from the appropriate national supervisory authority of each EFTA-EEA country; and also
- a Management Board: comprising representatives from the appropriate national supervisory authorities and the Commission.

The ESFS is designed to overcome perceived deficiencies in the existing framework and provide a system that is in line with the objective of a stable and single EU financial market for financial services – linking national supervisors into a strong Community network.

Next steps

It is the Commission's intention to bring forward, as soon as possible, the legislative changes to put in place the new framework for EU supervision, on the basis of the orientations set out in this Communication and after further consultation of stakeholders, so that the necessary measures are adopted in time for the renewed framework to be up and running during 2010. Since its publication, the Communication has also already been the subject of review and endorsement by both [Ecofin](#) and the [European Council](#). The Council conclusions provide firm political backing for the proposed new arrangements to be put in place during 2010, subject to a few agreed refinements. In particular the Council has: indicated that the "members of the General Council of the ECB will elect the chair of the European Systemic Risk Board"; stressed that "decisions taken by the European

Supervisory Authorities should not impinge in any way on the fiscal responsibilities of Member States"; and stated that the European Supervisory Authorities "should also have supervisory powers for credit rating agencies" – without mention of any such powers regarding EU central counterparty clearing houses. The Commission's Communication has been opened for comment and [ICMA has responded](#).

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Capital Requirements Directives

On 6 May the European Parliament adopted, by a large majority, a [legislative report which amends the Capital Requirements Directives](#) (CRD) to improve the transparency and the supervision of the financial system so as to ensure proper risk management in the banking sector. Member States must transpose the proposed legislation by 31 October 2010 and apply the new provisions from the end of 2010.

Provisions include new rules to improve the quality of capital, by introducing specific provisions concerning hybrid tier 1 instruments, and controls on liquidity risk, to guard against banks having trouble gaining access to day-to-day funding. Banks must also limit their exposure to any individual source of risk, including inter-bank exposures. The basic requirement is that a bank may not expose more than 25% of its own funds to a client or a group of connected clients, after taking account of credit risk mitigation. It is agreed that, by the end of 2011, steps will be taken to seek further harmonisation of national provisions relating to the large exposure regime.

To strengthen the crisis management framework over the EU banking sector, it has been agreed to establish colleges of supervisors to facilitate cooperation among national authorities dealing with cross-border financial institutions. It is also considered that, in case of a conflict between members of a college, independent advice and a mediation mechanism at Community level should be available. Therefore, the Commission is asked to put forward by 31 December a legislative proposal to achieve further supervisory integration, with a view to establishing an EU level supervisory system by no later than 31 December 2011.

The proposals adopted also include measures relating to securitisation, in particular to ensure that an institution issuing

Capital Requirements Directives - continued

an investment retains a material interest in the performance of the proposed investment. The agreed retention rate is at least 5% of the total value of the securitised exposures. In addition a strong review clause has been inserted, asking the Commission, by 31 December, to come up with a possible proposal to increase the retention rate, after consulting CEBS and taking into account international developments. In this regard, CEBS has already received two European Commission [calls for technical advice](#) on Article 122a of the amended CRD.

Further, it is considered that credit default swaps (CDS), the most traded type of derivative in recent years, as well as all over-the-counter (OTC) products, also need to be better regulated. The agreed text therefore calls on the Commission to put forward, by 31 December, legislative proposals to set up an EU central counterparty (CCP) to reduce the risks of these instruments and to enhance transparency in the OTC market.

Finally, reviews are called for by the end of the current year covering: possible counter-cyclical measures; supplementary measures (such as a leverage limit); and the rationale underlying the capital requirements calculations. The Commission has already recently [consulted on further possible CRD changes](#) to strengthen capital and disclosure requirements for the trading book and for complex securitisations (similar to consultations that are being conducted by the Basel Committee on Banking Supervision); and [with regard to remuneration policies](#). Nevertheless, any increases to capital will be mandated after the financial crisis, to ensure banks do not curtail lending that is needed to fight the recession.

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Credit Rating Agencies Regulation

On 23 April an [EU Credit Rating Agencies \(CRA\) Regulation](#) was adopted by a large majority. This is now undergoing textual formalisation (most likely to be completed by the autumn) in anticipation of subsequent publication in the *Official Journal*, 20 days following which it will enter into force as Community law (without needing transposition by Member States). CRAs already operating in the EU (assuming they intend to apply for

registration) must adopt all necessary measures to (i) comply with the Regulation's provisions by six months, and (ii) submit their application by no later than nine months, after entry into force of the Regulation.

From 12 months after the Regulation's entry into force, EU authorised financial institutions can only use for "regulatory purposes" (belatedly defined as "the use of credit ratings for the specific purpose of complying with Community law, as implemented by the national legislation of the Member States") those ratings that are produced in compliance with the Regulation – in the first instance that means only those ratings issued by duly registered EU CRAs. For ratings issued by non-EU CRAs to be deemed able to be used in the EU for regulatory purposes, Article 4 offers two possible avenues:

- registered EU CRAs may "endorse" a rating produced by a non-EU office of the same group, subject to a number of conditions, including: that the non-EU office must be registered and supervised in its jurisdiction; a cooperation agreement must be in place between the applicable EU and non-EU regulator(s); and the EU CRA must verify and demonstrate to its EU regulator(s) that the conduct of the non-EU rating office fulfils requirements "at least as stringent" as those in the EU Regulation; or
- CRAs with no EU presence may be "certified" by the EU, for which a number of conditions must be satisfied, including: that the European Commission must decide that the non-EU regulatory and supervisory framework is "equivalent" to the EU's; and that the CRA must not be of systemic importance in any Member State.

A rating is deemed issued when published on the CRA's website or by other means, or distributed by subscription. Subject to relevant conditions, the Regulation does not apply to various specified cases, including: private ratings; credit scores; ratings produced by export credit agencies; or certain ratings produced by central banks. Investment research and recommendations and other opinions about the value/price of a financial instrument/obligation are not deemed to be credit ratings.

One other late change provides that: "When a CRA issues credit ratings for structured finance instruments it shall ensure that rating categories that are attributed to structured finance instruments are clearly differentiated using an additional symbol which distinguishes them from rating categories used for any other entities, financial instruments or financial obligations". It had been expected that CRAs would have the alternative of providing detailed disclosure as to differences in methodology applicable to structured

Credit Rating Agencies Regulation - continued

finance instruments and that CRAs would have opted to utilise that alternative.

CESR has formed an [expert working group](#) to help develop guidance that it must provide in respect of a number of practical aspects. Work is being organised in three sub-groups:

- registration procedure, colleges, cooperation and mediation;
- enforcement and substantive registration requirements; and
- disclosure and the central repository.

Work through the summer is planned to lead to consultations, based upon which finalised guidance notes will then be developed by about the end of March 2010.

As a follow-up to the [G20 conclusions of November 2008](#) and the [European Commission Communication on CRAs](#) of March 2006, CESR was tasked to report to the Commission

and the Economic and Financial Committee on the progress made by EU-based CRAs towards compliance with the [revised International Organisation of Securities Commission \(IOSCO\) Code of Conduct for CRAs](#), published in May 2008. CESR duly completed this task, delivering its [report on compliance of EU-based CRAs with the IOSCO Code](#) on 25 May this year.

On 15 June the Joint Forum released the final version of its paper entitled [Stocktaking on the use of credit ratings](#). The paper was developed in response to a request from the Financial Stability Forum for a stocktaking of the uses of external credit ratings by its member regulatory authorities in the banking, securities and insurance sectors. The report will provide policymakers and others with a useful reference when considering the extent to which credit ratings should in future be relied on in regulation and supervision.

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The Swedish Presidency

The Swedish Government took over from the Czech Government the [Presidency of the Council the European Union on 1 July](#). The economic and financial crisis will overshadow all other political issues on the Council Presidency agenda. In its [work programme](#), the Presidency sees its activities as being shaped by the continued management of the economic and financial crisis, including work to solve the problems in the financial market and deal with the recession and rising unemployment. The Swedish Presidency will be occupied, *inter alia*, with the [European recovery plan](#).

In terms of regulatory developments, the Swedish priorities are: the proposal for an Alternative Investment Fund Managers Directive, CRD amendments, derivatives and supervisory arrangements. Developments relating to the review of Financial Services Action Plan Directives (Market Abuse and Markets in Financial Instruments) are expected in the fourth quarter of 2010, and require a limited contribution from the Presidency.

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Market Abuse Directive

On 15 May, the Committee of European Securities Regulators (CESR) published its *Third set of guidance on the Market Abuse Directive* (MAD) in the form of a [feedback statement](#) and [final guidelines](#) covering insider lists, suspicious transaction reports (STRs), stabilisation and buy-back programmes and the two-fold notion of inside information. The *Third set of guidance* follows two consultations – a [first consultation](#) in May 2008 on insider lists and STRs (to which ICMA submitted a [first response](#) jointly with the British Bankers' Association) and a [further consultation](#) in October 2008 on stabilisation and buy-back programmes and the two-fold notion of inside information (to which ICMA submitted a [further joint response](#)). Concerning stabilisation and buy-backs in particular, the final guidelines are substantially unchanged from the draft guidance set out in the October 2008 further consultation, with the feedback statement noting that:

- CESR is still developing its policy on buy-backs;
- when outside the stabilisation safe harbour, the burden of proof regarding abuse lies with the regulator;
- CESR will not pursue the home/host approach, focusing instead on reducing discrepancies between its members;
- refreshing the “greenshoe” (primarily relevant to the equity space) and “sell” transactions are outside the safe harbour;
- when interpreting stabilisation, liquidity provision is not the same thing as price support;
- issues arising under inconsistent third country rules remain within the scope of the European Commission's work on international harmonisation, with CESR hoping some comfort can be obtained from its view that being outside a safe harbour is not per se abusive; and
- CESR is looking into options for centralising access to national regulators' reporting forms and e-mail addresses (CESR rejected centralised/harmonised reporting).

On 10 June, ICMA submitted a [response](#) (with the British Bankers' Association) to a Commission [call for evidence](#) on the MAD. The response addressed:

- the scope of MAD (its current scope being limited to “regulated” markets, the alignment of the MAD and Markets in Financial Instruments Directive (MiFID) definitions of financial instruments);
- inside information (its definition and related disclosure obligation, the prohibition of trading “on the basis of” rather than “whilst in possession of” inside information, insider list requirements, suspicious transaction reports and authorities' rights of access to data); and
- market manipulation (its definition, accepted market practices and short selling), including consideration of the application of MAD in the context of the commodity markets.

Concerning market manipulation exemptions for buy-back programmes and stabilisation activities in the context of the debt capital markets, the response noted:

- market participants have invested substantial resources in understanding and adjusting to the MAD (including its current safe harbours), have got comfortable with the legal and regulatory subtleties involved (substantially helped by CESR's view in the *Third set of guidance* that activities falling outside the regime's safe harbours do not *per se* constitute market abuse) and so do not consider that the safe harbours should be revisited;
- the current stabilisation safe harbour is helpful and should be maintained (and though over-allotments beyond 5% do at times occur when necessary, no particular higher threshold would be specifically meaningful); and
- the desirability of greater convergence in the application of the MAD's Stabilisation Regulation within the EU (including application of a single “home” Member State's jurisdiction concept) and, more generally, of greater rules harmonisation at the global level.

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Retail structured products

There have been several recent developments concerning retail structured products, including at EU level a CESR [consultation](#) on MiFID complex and non-complex financial instruments for the purposes of the MiFID appropriateness requirements and a Commission [Communication](#) on *Packaged retail investment products* (PRIIPs). The PRIIPs Communication, *inter alia*, suggests a new “horizontal” legislative regime for retail products cutting across existing “vertical” legislation (including the Prospectus Directive) and potentially involving extension of the UCITS “key investor information/document” (KII/KID) concept to the debt securities space.

It will be interesting to see the Commission’s detailed proposals in due course – not least in relation to: (i) defining the “retail” characteristic of the new regime so that it does not disproportionately impose burdensome retail protection standards on the non-retail markets; (ii) addressing the tension between prescribing complex product disclosures to be “short and simple” whilst containing “all key information” (all in a context of differing national issuer liability regimes); and (iii) clearly and logically delineating the division of responsibilities between “manufacturer” issuers and distributors.

In this last respect, ICMA participated in the 2007 publication of [principles](#) for managing the provider-distributor relationship in the context of retail structured products. ICMA is planning to continue to follow these and other initiatives through the Joint Associations Committee, which also includes the London Investment Banking Association (LIBA), the International Swaps and Derivatives Association (ISDA) and the Securities Industry and Financial Markets Association (SIFMA) and its European Securitisation Forum (ESF).

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Asset servicing

An [updated version](#) of the *Market practice book* (MPB) – previously covered in an article on page 15 of the [January 2009 edition](#) of this Newsletter concerning the work of the International Securities Market Advisory Group (ISMAG) – has been published by the two International Central Securities Depositories (ICSDs), Euroclear and Clearstream. New material in the updated version includes *inter alia* (in Annexes 5 and 6) five template checklists intended to help ensure inclusion of relevant information when asking the ICSDs to accept issuance programmes and stand-alone issues and when notifying them of rate fixings, partial redemptions and final redemptions. Excel versions of the five templates have been made available for convenience on Euroclear’s [ISMAG webpage](#) (under the “New Issues Working Group” and “Income Working Group” headings respectively), which also hosts a [naming convention](#) for final documentation e-mail attachments.

Separately, the International Capital Market Services Association (ICMSA) has published a [recommendation](#) on payment days, the salient features of which are that (i) the number of included jurisdictions be minimised and (ii) the jurisdiction of the agent’s location need not be included. The recommendation is intended to apply to “open” days on which payments are to be made, rather than days contractually relating to other events (such as rate determinations).

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The prospects for the primary markets with Peter Eisenhardt, Principal and European Head of Origination, Bank of America Merrill Lynch and Chairman, ICMA’s Euro Commercial Paper Committee; Bertrand de Mazières, Director General Finance, European Investment Bank and Chairman, AMTE Council; Kate Craven, Director, Legal Department, Barclays Capital and Chair, ICMA’s Legal and Documentation Committee; Lachlan Burn, Partner, Linklaters LLP; Martin Egan, Global Head of Primary Markets and Securitisation, BNP Paribas and Chairman, ICMA’s Primary Market Practices Committee.

A European EDGAR?

The Transparency Directive (TD) requires each Member State to appoint one or more Officially Appointed Mechanisms (OAMs) to centrally store the regulated information of all issuers whose securities are admitted to trading on a regulated market. (Regulated information includes all financial information, major holding notifications, inside information and all information an issuer is required to disclose under domestic laws, regulations or administrative provisions.) The TD also requires the competent authorities of the Member States to draw up guidelines to create “a single electronic network, or a platform of electronic networks across Member States”. However, the TD gives little guidance about how the network(s) should operate, what level of integration is required, whose responsibility it is to set it up, or how it would be funded.

The work of setting up an EU network of OAMs has been laborious, largely due to this lack of clarity. In October 2004, CESR gave its opinion that the aim of the TD requirements should be the creation of a “one stop shop” for the European investor – ie that an investor should be able to access, from one place, all regulated information generated by all issuers admitted to trading on all regulated markets throughout Europe. It presented two options: (i) the creation of a single database for all Member States; or (ii) the creation of an integrated network of national databases.

In 2005, the Commission said that, in its view, the European architecture for the storage of regulated information would be likely to “consist of a type of integrated network of national databases allowing for sufficient flexibility and scalability, with the final objective of offering a one-stop shop for end-users” – ie the second option. The Commission asked CESR to provide an opinion on two preliminary issues related to this option: (i) how an agreement on technical requirements to allow technical interoperability of OAMs could be obtained and how to conduct ongoing supervision of such a joint project; and (ii) an analysis of the cost and funding implications for Member States at the initial stages of the creation of such a EU-wide network.

CESR responded by publishing a *Consultation paper setting out four possible network models*. Model A envisaged a central access point application for searching the whole of the OAM network. This central access point application would sit on a central server outside all the OAMs. Model B envisaged investors using the software application of any one OAM to search the entire OAM network. Model C envisaged a central server hosting an application, containing

a complete list of issuers and links to each OAM. The list would be used by investors to access the relevant national OAMs. Finally, Model D envisaged that each national OAM carry a list of links to all other national OAMs on its website. An investor would then have to select the appropriate OAM and access it directly through the web link. On the basis of the responses received and discussions amongst CESR members, CESR concluded that Model C was the preferred network model because it was simpler than Models A and B and offered adequate functionality without incurring excessive costs.

In October 2007 the Commission endorsed CESR’s advice in *Recommendation 2007/657/EC*, asking Member States to take the necessary steps to interconnect the OAMs on the basis of model C. In addition, the Commission asked CESR to consider the future development of the pan-European network by September 2010. In particular, CESR must examine the feasibility, including a cost/benefit analysis, of requiring the use of “harmonized searching facilities based on a set of common search keys and reference data items, thus harmonizing the methods of classifying and identifying the information to store”. CESR will also examine the feasibility of dynamic or chain searches and multiple-country searches with a single request.

Progress so far

As of September 2008, 21 Member States had set up OAMs. CESR has also taken forward the Model C concept by enhancing CESR’s existing MiFID database of shares admitted to trading on regulated markets. By clicking on the ISIN code or the name of the shares, users are linked to either the OAM of the issuer’s country of incorporation or another CESR page where all the OAMs of the relevant country are listed. While CESR’s interim measures mean that there is some access to issuer information across the EU, there are problems. First, regulated information is only available for share issuers; issuers of only debt securities are not included in the database. Second, there is the language problem. National OAMs only provide information in the national language or a language “common in the sphere of international finance” as there is no TD requirement for issuers to provide information in other languages. Therefore, an investor in France wanting information on a German company would be likely to view documents written in German. Finally, there is the problem of document classification. Member States are not agreed on what constitutes “regulated information”. For

A European EDGAR? - continued

example, prospectuses are not included in the TD definition of “regulated information”, though some Member States would classify them as such. Therefore, a national OAM would not be obliged to display documents falling outside its national parameters of “regulated information”. Ultimately, it is unclear to what extent the information being displayed will be used or useable.

CESR has informally indicated that in response to the Commission Recommendation it expects to issue a call for evidence by the end of 2009 and follow that up with a consultation paper in early 2010, which should allow for sufficient time to finalise its guidance by the September 2010 deadline. Given the work that has taken place so far, we feel that it is likely that the scope of CESR’s forthcoming guidance may be limited to building upon Model C.

Developments in the US

The position in Europe contrasts starkly with the position in the US. EDGAR is the SEC’s Electronic Data Gathering, Analysis, and Retrieval system that was introduced in the early 1990s. It holds public filings such as registration statements, prospectuses, annual reports, quarterly reports and ongoing disclosure obligations of all US public companies filed since January 1994. Not only is the system used by companies to file the relevant information with the SEC, but the information is also freely accessible and searchable by the public.

The SEC has recently announced that it will gradually phase out EDGAR and replace it with Interactive Data Electronic Applications (IDEA) which is based on eXtensible Business Reporting Language (XBRL). Most EDGAR filings are currently available only in government-prescribed forms. Investors looking for information must sift through one form at a time. However, starting this year, the SEC is requiring certain companies to report financial information using XBRL. By 2011, all publicly traded companies and mutual funds will report in XBRL.

What is XBRL? XBRL assigns each individual item in a company’s financial statement with an identification code or “tag”, similar in function to a bar code. With every number on a financial statement individually labelled, financial information for all companies in the database can be easily searched on the Internet, downloaded and reorganised for comparative and analytical purposes. IDEA will then allow investors instantly to collate information from thousands of companies and forms and create reports and analysis in any way they choose, since companies will have filed their information using the XBRL format.

It has been found that the [time](#) it takes auditors to review a bank’s quarterly financial information in XBRL has dropped from about 70 days to two. Much of the motivation behind the increasing use of XBRL and IDEA is that investors themselves should be given the capability to better assess different securities and issuers rather than having to rely on advisors, brokers and other intermediaries. It is worth noting that adoption of XBRL is growing worldwide. China, Japan, Korea, Singapore and Spain all require listed companies to submit data in XBRL format.

Next steps

If Europe wishes to have a system that is more like the SEC’s EDGAR or IDEA, the Commission and Member States will need to explore the extent to which political sentiment has changed in favour of wider and more accessible issuer transparency. Given technological advances, EU proposals to further develop Model C seem misplaced.

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Future of the OTC markets

There is a perception that OTC markets are under threat. In May, US Treasury Secretary Timothy Geithner set out his [views](#) on the changes that need to be made for the US Government effectively to regulate the over-the-counter (OTC) derivatives market, which under current law is largely excluded or exempt from regulation. In particular, he said that “laws should be amended to require clearing of all standardized OTC derivatives through regulated central counterparties (CCPs).” However, there were a number of other remarks of note in the letter which could have significant consequences for the OTC markets: “Market efficiency and price transparency should be improved in derivatives markets by requiring the clearing of standardized contracts through regulated CCPs ... and by moving the standardized part of these markets onto regulated exchanges and regulated transparent electronic trade execution systems for OTC derivatives and by requiring development of a system for timely reporting of trades and prompt dissemination of prices and other trade information. Furthermore, regulated financial institutions should be encouraged to make greater use of regulated exchange-traded derivatives. Competition between appropriately regulated OTC derivatives markets and regulated exchanges will make both sets of markets more efficient and thereby better serve end-users of derivatives.”

More recently, Paul Tucker, Deputy Governor of the Bank of England, [stated](#) that the Bank of England also agrees that more of the vanilla OTC markets should be cleared via CCPs and that: “The financial community must also be open to more trading in core, vanilla markets going via exchanges or other well-designed and open trading platforms. If well constructed, that could help to preserve liquidity when times are tough. We would, for example, like to see serious consideration of whether the corporate bond markets could benefit through something along those lines.” This sentiment has since been repeated in the Bank of England’s [Financial stability report](#), published in June.

Setting these comments in context, it is important to understand how the fixed income markets work. First, most fixed income products trade very infrequently compared to equities. Recent data shows that only 3,000 of the top bonds (by volume) traded at least once a day on average. Of the top 100 bonds by volume trade, the highest trade-count bond traded 10,000 times in the year, whilst others traded only 6 times in the year. Accordingly, there is rarely a constant supply of buyers and sellers looking to trade sufficient to sustain a central pool of investor-provided liquidity. In other

words, unlike equity markets there is seldom a continuous two-way market of buyers and sellers whereby a minor change in price by one or the other can result in a trade.

Instead, liquidity is provided by dealers who operate in two ways. First, they put their own capital at risk by, for example, buying bonds from an investor even if they do not have a buyer to whom they can on-sell the bonds. They take the risk that in due course they will find a buyer to whom they can sell the bonds at a profit. Second, they take an order – eg from a client who wants to buy a quantity of a particular bond – and will search the market for an investor who is prepared to sell those bonds. The dealer will then seek to negotiate a price with the buyer and then seller which satisfies both clients and which enables the dealer to make a profit from the difference between the price he charges the seller and the price he charges the buyer. These reasons, together with the largely illiquid nature of most debt securities, are why these securities trade largely OTC.

Much of the regulatory attention on the market since the crisis began has focused on issues of transparency, particularly post-trade transparency (or the publication of details of actual transactions). Important as transparency is, it is doubtful that problems of transparency are the main contributors to illiquidity today. The fixed income markets cater for the wide-ranging requirements of issuers and investors and this can only be done by dealers who either commit their capital to the market, thereby providing immediate execution of a client order, or who undertake to search for investor counterparties to their clients’ desired trades and negotiate mutually satisfactory prices. This latter service may take hours, days or even weeks, and may not result in the client achieving as good a price as when his order is executed immediately.

The crisis has not only forced dealers to cut the amount of capital committed to the market (and therefore increased the amount of client business that is done on a lengthier order-matching basis), but increased levels of credit and market risk have severely restricted the degree to which a given amount of capital can provide liquidity to the market. Market uncertainty has forced dealers to reduce the size in which they are prepared to deal and widen the bid/offer spread which they will show to clients. Financing of positions has become increasingly difficult as secured lenders have been unwilling to accept all but the most liquid and risk-free securities as collateral or have demanded extra “haircuts” (ie the excess value of securities given as collateral for a given amount of lending). Investment institutions have been increasingly unwilling to lend securities into the market which dealers need to borrow to cover short positions resulting from their market making activities.

Future of the OTC markets - continued

As the financial system stabilises and banks recapitalise, so the market is showing signs of returning to normal functioning. Already the new issues market is showing record levels of issuance, though much of the issuance is currently by government-guaranteed banks which investors perceive as being of low risk. The relationship between credit default swaps and cash securities is stabilising as liquidity conditions become less precarious, thus helping dealers to hedge their positions.

Just as an important element of fixed income markets has been the willingness of dealers to commit capital to facilitate investor decisions, so they are subject to systemic shocks which impact the provision of dealer capital and the risks which that capital underwrites. The impact of the financial crisis on the liquidity of the market should not be seen as a fundamental and irrevocable failure of the OTC model. Rather it is evidence of what happens when a high degree of uncertainty as to the creditworthiness of market counterparties and the probability of default by issuers take precedence over all other considerations.

Over the last decade, various alternative trading mechanisms for fixed income products have been offered to the market, by exchanges and MTFs. Their success has been very limited. While it appears that retail trades may usefully be accommodated on electronic order-matching systems (such as the Swiss Stock Exchange) as an alternative to the OTC market, even here there is a need for OTC traders to balance the supply and demand for specific securities. Institutional investors on the other hand have shown great unwillingness to use such systems, preferring to negotiate bilaterally with dealers even in the current difficult market conditions.

From a regulatory and public policy perspective the need for better monitoring of the systemic risks in the market as well as risk held, on or off balance sheet, by dealers is one of the lessons of the crisis and that is where regulatory attention should be focussed.

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Bond market transparency

As readers of previous editions of this Newsletter will be aware, ICMA's sell side has been looking at post-trade transparency issues for some time. In particular, considerable thought has been given to the [CESR consultation](#) on non-equities markets transparency that was published in December 2008. We understand that there is now considerable pressure within CESR to conclude that corporate bond markets would benefit from greater post-trade transparency. At the same time, we also understand that both our buy-side and sell-side firms are aware of numerous difficulties in getting business concluded since Lehman's collapse last year.

ICMA considers that the market needs to do more to investigate the relationship between well designed trading transparency on the one hand and liquidity, market confidence and integrity on the other. In particular, there needs to be a better understanding of the information needs of the buy side and sell side in order for them effectively to participate in the market. Therefore, ICMA is trying to build a representative industry working group whose remit will be to look at transparency, liquidity and related issues in the corporate bond market. The group will also look at credit default swaps (CDS) as necessary for a proper assessment of the corporate bond market. The group's aim will be to see if the buy and sell sides can agree a market-led initiative to get the market working more efficiently.

We have set out our intentions in this regard in a [letter](#) to the FSA, which responds to discrete aspects of the FSA's Discussion Paper DP09/2: *A regulatory response to the global banking crisis* that accompanied the publication of the Turner review.

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Unregulated financial markets and products

On 5 May, the International Organization of Securities Commissions (IOSCO) Technical Committee published a consultation report, *Unregulated financial markets and products*, prepared by its task force on this topic. This report contains interim recommendations for regulatory action designed to improve confidence in the securitisation process and the market for credit default swaps (CDS). The IOSCO task force was established November 2008, in response to concerns expressed by the G20 regarding the crisis and the pivotal role that certain unregulated market segments and products had played in the evolution of capital markets.

The interim recommendations contained in the report address issues of immediate concern with respect to:

- securitised products, including asset-backed securities (ABS), asset-backed commercial paper (ABCP) and structured credit products such as collateralised debt obligations (CDOs), synthetic CDOs, and collateralised loan obligations (CLOs); and
- CDS.

The task force focused on these particular areas due to the significance of securitisation and CDS to credit availability in the real economy, their contribution to the management of individual and systemic risks, their recent rapid growth and the important role they play in global markets. In proposing these interim recommendations, IOSCO believes:

- that a measured regulatory response is required, taking into account industry initiatives, to strengthen the operation of the securitisation and CDS markets; and
- that implementing these regulatory actions may assist in restoring confidence in, and promoting the fairness, efficiency and orderliness of, international financial markets.

On the basis of the interim recommendations for these markets, the report also identifies the need for further consideration of the other unregulated financial markets and products before general recommendations can be developed. Once it has reflected on responses to this consultation paper it receives, IOSCO will finalise its recommendations and consider how best to implement them in the interest of fostering consistent regulatory approaches across markets.

International Council of Securities Associations' response

ICMA has contributed to the [comment letter submitted by the International Council of Securities Associations \(ICSA\)](#), which was compiled by the ICSA Standing Committee on Market Structure. This response strongly supports the emphasis given in the IOSCO report on the need for coordination and integration of regulatory measures and welcomes the acknowledgment and encouragement it gives to industry initiatives. It goes on to provide some specific observations on each of the two areas of focus of IOSCO's report and solicits ongoing collaboration to examine whether, where and in what form further regulation should be necessary.

European Repo Council's response

The [European Repo Council](#) has also welcomed the Technical Committee consultation report. The steps referred to in this consultation paper would effectively widen the range of collateral possibilities for repo trading. In stressed times, the quality of collateral and the ability to assess this quality are important. The European Repo Council considers that rebuilding investors' confidence would help improve collateral management possibilities in the repo market, and as a result the functioning of financial markets.

Disclosure as regards the quality and risks of the underlying asset pool should be improved. This is why the European Repo Council also believes that the regulatory focus should be strengthened as regards bilateral clearing, where bilateral parties manage underlying collateral that is not accepted by central counterparties. Indeed market participants, as mentioned in the Technical Committee's consultation report, should be able to evaluate the risks attached to assets.

Moreover, the international financial crisis has highlighted the global scale of markets and their interconnectivity. The collateral analysis provided in the latest [ICMA European repo market survey conducted in December 2008](#) shows that almost 17% of collateral is from outside the European Union. ERC members trade with counterparties on a global scale. Therefore steps, as highlighted in the recommendations of this consultation paper, need to be consistent at an international level.

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Credit claims

The European Repo Committee (ERC) is leading the project for the creation of a secondary market for credit claims. It is worth noting that the ECB has reported on this issue in *Report on the establishment of a secondary market for bank loans*. The ERC has an interest in using this type of collateral beyond ECB transactions, and therefore ensuring that credit claims can also be used on a bilateral basis, henceforth widening its pool of eligible collateral. Credit claims are already eligible under the ECB criteria.

The Association of National Numbering Agencies (ANNA) is currently working on a common identification code for credit claims, and the new Financial Collateral Directive, approved by the European Parliament in December 2008, has clarified the credit claims definition and removed the notification process. The Directive is due to be transposed by Member States. Swift is currently in discussion with the Dutch and Belgian Central Banks regarding messaging facilities. The ICSDs are continuing with their work on a common database for the identification of credit claims.

The ERC has requested ICMA to produce an annex to the Global Master Repurchase Agreement (GMRA) for credit claims aiming at providing a solid legal base for the development of the secondary market in all EU Member

States. In September the joint ECB/ERC working group on credit claims, which also includes the Loan Market Association and representatives from Swift and the European Banking Federation (EBF), will take stock of all the work related to credit claims.

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The European interbank collateralised market

The EBF proposed at the last meeting of the [Contact Group on Euro Securities Infrastructures](#) (COGESI) to remedy dysfunctional money markets by creating a European interbank collateralised market (EICM). European banks, with the catalytic role of the ECB and the operational support of the national central banks in the Eurosystem, would promote the establishment of this market. In addition to the repo market, the EICM could involve some form of default risk-sharing. According to the scheme, the existence of a fully fledged European central clearing counterparty would be a prerequisite. This would become a party to every interbank transaction acting as buyer to market participant sellers



Godfried De Vidts, Chair of ICMA's European Repo Committee

and seller to market participant buyers. The ERC remains convinced that the European repo market is the product of choice, but all initiatives that could help re-establish a robust funding market will be considered with interest by ERC members.

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Explaining the “L” in LIBOR

The Foreign Exchange and Money Markets Committee, which is independent, has discussed the definition of “BBA LIBOR” with a view to ensuring that the rates remain the best possible benchmark for the rapidly changing markets. To date, the notes accompanying the definition of “BBA LIBOR” state that: “Contributions [to the rate fixing process] must represent rates formed in London and not elsewhere”.

In a press [release on 19 June](#), the British Bankers’ Association (BBA) referred to a recent meeting where the Committee considered that this could be clarified further as there could be different interpretations of what constitutes a rate “formed in London”. In addition, there are many major participants in the London money markets that are either not physically located in London, or do not book trades in London. Therefore, with immediate effect, the note released by the BBA interprets the definition as follows: “Contributions must represent rates at which a bank would be offered funds in the London money market”.

This clarification will not affect the way in which current contributors formulate their rate submissions. However, it may allow banks that participate in the London markets, whose eligibility for inclusion in the fixing was not previously clear, to apply to join the panels. According to the BBA, this is in line with the commitment made last year as a part of the LIBOR consultation to allow expansion of the LIBOR panels, whilst ensuring that LIBOR remains a tightly defined measure of the cost of unsecured interbank funding each morning in the London market.

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Accounting standard: derecognition

On 31 March, the International Accounting Standards Board (IASB) published an Exposure Draft (ED) on a revised derecognition model for financial instruments: [Derecognition: proposed amendments to IAS 39 and IFRS 7 \(EC/2009/3\)](#). The ED proposes to replace the existing guidance on derecognition of financial assets and financial liabilities in IAS 39 and the related disclosures required by IFRS 7.

Comments on the proposals are expected before 31 July. The ERC is monitoring the impact of the proposal on repo markets.

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ICMA-ERC European repo market survey

The 17th ICMA-ERC survey of the European repo market will be published in early September. The survey provides reliable figures on the size and structure of the European repo market, based on a snapshot of trades outstanding in the market on a particular day (10 June) and also illustrates key trends in trading, use of tri-party repo and collateral type.

All banks in Europe who are active in the repo market are encouraged to participate. For more information, contact: reposurvey@icmagroup.org

Proposal on Alternative Investment Fund Managers

Earlier this year a consultation was undertaken by the European Commission regarding the regulation and supervision of [hedge funds](#). ICMA's Asset Management and Investors Council (AMIC) [responded](#) to the consultation highlighting key points for the Commission to consider: the lack of a formal, legal definition of the term "hedge fund"; the current regulatory requirements and the need for a global approach in regulation; the role of hedge funds in the crisis; the need to ensure that techniques and actors are not confused; and the need for the sophisticated investor base of hedge funds to be recognised.

Subsequent to this consultation paper, an [open hearing on hedge funds and private equity](#) was held at the end of February. Following the [G20 conclusions](#) that "hedge funds and their managers will be registered and will be required to disclose appropriate information on an ongoing basis to supervisors and regulators", a [proposal for a Directive on Alternative Investment Fund Managers \(AIFM\)](#) was published in April. The proposal aims to create an encompassing regulatory and supervisory framework for AIFMs in the EU, applying in effect to all funds that not covered by the UCITS Directive. The proposed Directive has a broader coverage than just hedge funds, applying also *inter alia* to private equity funds, real-estate funds and commodity funds.

The proposed Directive will require all AIFMs within its scope (the Directive will apply to those AIFMs managing a portfolio of more than €100 million; a higher threshold of €500 million applies to AIFMs not using leverage) to be authorised and to be subject to harmonised regulatory standards on an ongoing basis. The proposal involves core common requirements for EU-based managers of all types of non-UCITS funds in the areas of operation and organisation. Additional requirements apply to managers of leveraged funds. Although the introduction of the passport is welcomed, other provisions are of concern: the three year delay for non-EU funds to use the marketing passport; the appointment of European depositors and other service providers; and the introduction of capital requirements.

Initial discussions on the proposal have already started in Council. For the new European Parliament, this Directive will be one of the first legislative proposals to be considered from around September onwards. It is expected that the Directive will be approved by summer/autumn 2010 and implemented in 2011.

Oversight of hedge funds

The International Organization of Securities Commissions' (IOSCO) Technical Committee published in June its [Hedge funds oversight: final report](#) which contains six high level principles that will enable securities regulators to address, in a collective and effective way, the regulatory and systemic risks posed by hedge funds in their own jurisdictions while supporting a globally consistent approach. The six high level principles are as follows

- Hedge funds and/or hedge fund managers/advisers should be subject to mandatory registration.
- Hedge fund managers/advisers which are required to register should also be subject to appropriate ongoing regulatory requirements relating to: organisational and operational standards; conflicts of interest and other conduct of business rules; disclosure to investors; and prudential regulation.
- Prime brokers and banks which provide funding to hedge funds should be subject to mandatory registration/regulation and supervision. They should have in place appropriate risk management systems and controls to monitor their counterparty credit risk exposures to hedge funds.
- Hedge fund managers/advisers and prime brokers should provide to the relevant regulator information for systemic risk purposes (including the identification, analysis and mitigation of systemic risks).
- Regulators should encourage and take account of the development, implementation and convergence of industry good practices, where appropriate.
- Regulators should have the authority to cooperate and share information, where appropriate, with each other, in order to facilitate efficient and effective oversight of globally active managers/advisers and/or funds and to help identify systemic risks, market integrity and other risks arising from the activities or exposures of hedge funds with a view to mitigating such risks across borders.

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Central counterparty clearing

In the EU, work continues toward central counterparty (CCP) clearing, following the [letter to the European Commission, dated 17 February](#), in which a group of nine firms committed to engage to use EU-based CCP clearing for eligible EU credit default swaps (CDS) contracts by the end of July. As anticipated, progress is being regularly examined in an ongoing series of meetings with the Commission. Issues under examination include work, coordinated by ISDA together with market participants, on practical details related to restructuring credit events and CDS coupons, as well as the progress of potential CCP infrastructure providers. Eventually each firm will have to make an individual choice on which central clearing house or houses might best meet its risk management objectives, always subject to regulatory approval of any such clearing house in Europe.

Recent associated announcements also reflect progress being made. These include:

- 19 June – ISDA announced market practice changes for European and emerging markets CDS. By convention, firms will now trade European CDS with fixed coupons.
- 18 May – LCH.Clearnet SA announced that it would launch a credit default swap (CDS) clearing offering in December 2009.
- 6 May – Eurex Credit Clear: European OTC solution for credit default swaps - simulation launch.
- 1 May – ICE Clear Europe: Introduction of clearing services for credit default swaps during the first half of 2009.

On 1 April, the [Federal Reserve Bank of New York](#) hosted a [meeting](#) of major market participants and their domestic and international supervisors to discuss ongoing efforts to improve the infrastructure supporting the over-the-counter (OTC) derivatives market. It was noted that, since the [previous meeting with regulators in June 2008](#), industry participants had taken a number of steps to improve the OTC derivatives market infrastructure. As agreed, major financial market participants subsequently delivered a [letter committing to additional changes](#) in the market design and risk management for over-the-counter (OTC) derivatives. This was welcomed by the Federal Reserve Bank of New York in its [2 June press release](#).

Also in the US, Treasury Secretary Geithner commented, in [a letter dated 13 May](#), on changes necessary regarding the establishment of a comprehensive regulatory framework for OTC derivatives. Unsurprisingly the letter indicated that “laws

should be amended to require clearing of all standardized OTC derivatives through regulated central counterparties”. This has since been elaborated, as part of the US Treasury’s broader [financial regulatory reform report](#) issued on 17 June. Meanwhile it has also been noted that two Japanese clearing houses are examining [plans to introduce clearing for interest rate swaps and CDS next year](#). Japan Securities Clearing Corporation and the Tokyo Financial Exchange are working out details for the necessary infrastructure, as well as commercial and cooperation aspects.

Two other recent related developments are also noteworthy. The ESCB and CESR issued their [recommendations to increase safety and soundness of the post-trading infrastructure](#) – this contains recommendations aimed to increase the safety, soundness and efficiency of securities clearing and settlement systems and CCPs in the EU; and the European Commission, which has been considering possible measures to ensure OTC markets pose no risk to financial stability, has drafted a [Communication regarding derivatives markets](#).

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OTC trade confirmation matching

The international financial crisis has prompted the question how to make the OTC markets better and safer, while the growth of the over-the-counter (OTC) markets has brought a greater focus on regulatory and compliance issues. In particular, many firms – among them major banks and brokers – are concerned by the length of the confirmation process, and are keen to reduce the risk which might arise between the trade and settlement dates.

A recent survey conducted by an Association Française des professionnels des Titres (AFTI) working group found that 75% of OTC confirmations on the French OTC market are issued by fax, half of them being issued between banks. The use of faxes prevents a fast and effective control of transaction validity, thus increasing the risk of errors and even fraud. In addition, as a result of the back-office workload, the checking of the terms and conditions of transactions is often delayed until the settlement date, when any problems have already effectively occurred, increasing the number of settlement fails. In summary, from a compliance and reporting point of view, the use of fax confirmations does not provide a safe reporting tool.

How should this problem be solved? The first step would be to standardise OTC trade confirmations. This would require the market to reach a consensus on the various fields of the confirmation that need to be checked and matched. ISDA has created templates for many instruments. But each counterparty still chooses how those templates should be matched.

The market needs to find a flexible and secure tool to allow, through an automated system, trade confirmations to be sent and checked quickly. Some French market participants are in favour of electronic matching of OTC market confirmations, as this seems to fulfill the stated requirements. Various electronic matching platforms are already carrying out studies and working groups, involving banks and brokers.

How does electronic matching work? This system, which involves two counterparties entering the same trade into an electronic-matching platform, allows the almost instantaneous matching of the confirmations. If the confirmation fields are properly filled in, the system can achieve a perfect match. In case of a discrepancy between the two entries, the trade remains unconfirmed, and appears as such in each counterparty's files. After identification of an unconfirmed transaction, each participant can investigate, identify and correct the error. When amended, the trade can be reinserted in the system for the matching.

What should the next steps be? A market consensus is needed on a number of issues:

- First, the market needs to be consulted in order to reach a consensus on its willingness to move from the current system to an electronic one. It is obvious that all the participants must agree on this preliminary point, as they will all have to use the system to enable it to work.
- Second, the legal validity of the electronic confirmation needs to be checked. It will not be possible to enforce a system that cannot be used as evidence if a dispute arises.
- Third, the market needs to agree what is the best form of incentive to put the new system in place: eg whether an amendment to the French Code of Conduct would be sufficient, or whether new European legislation would be necessary.

In July and August 2009, the AMTE Council of ICMA will consult all its members through a short call for evidence in order to test the market. At the end of September, when the results of the study are available, a decision can be made on the best way forward. If the market does not regulate itself, then mandatory measures may be required from regulators.

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Clearing and settlement

TARGET2 Securities: management of fails

The TARGET2 Securities (T2S) information session held in April 2009 provided an update on recent developments relating to the project. The T2S internal governance structure was presented. The external governance of the project will be discussed at a later date.

The European Repo Committee (ERC) is carefully considering the management of the fails element in T2S, an issue brought to the T2S information session by Iberclear. Iberclear advocated that all central securities depositories (CSDs) should be given a window of time at the end of the day where they can apply “last resort mechanisms” when participants are not able to obtain the securities through borrowing in the market. The ERC expects European harmonisation and the establishment of a level playing field between CSDs.

CESAME 2: the removal of Giovannini barriers

The CESAME 2 group has presented the final report of the joint working group on [Barriers 2&10](#) and [Barriers 4&7](#). The report evaluates interoperability according to 10 features for different Member States. Three countries have been specifically considered in this context – the progress on interconnectivity in these markets (Greece, Italy and Spain) has also been analysed. It is expected that compliance with European Central Securities Depositories Association (ECSDA) Settlement Standards and ESF/ECSDA Matching Standards will address the majority of outstanding issues. The joint working group will monitor progress in the problematic areas highlighted and will consider whether there is a need to expand the scope or reprioritise work to address remaining Barriers 2&10 and 4&7 issues prior to implementation of T2S.

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Clearing and settlement: the importance of a resilient infrastructure with Klaus Löber, Advisor, Legal Services, European Central Bank; George Handjinicolaou, Deputy Chief Executive Officer, International Swaps and Derivatives Association; Mark Gem, Executive Vice President - Business Management and Member of the Executive Committee, Clearstream International; Yves Poulet, Chief Executive Officer, Euroclear Bank SA/NV.

Montreux 2009

ICMA's 41st AGM and conference took place in early June in Montreux and was attended by almost 500 ICMA members and other financial market participants. A webcast of the two-day conference is available from the [ICMA website](#).

Next year the AGM and Conference will take place in Brussels from 26 to 28 May.



Future of the international financial system with Michel Prada, Former Chairman, Autorité des Marchés Financiers; Svein Andresen, Secretary General, Financial Stability Board; Christopher Morris, Senior London Representative, Monetary and Capital Markets Department, International Monetary Fund; Hans-Joerg Rudloff, Chairman, ICMA and Chairman, Barclays Capital.



The effect of market developments on the investor landscape with Tim Skeet, Head of Covered Bonds, Bank of America Merrill Lynch and Chairman, ICMA's region for the UK, Ireland and the Americas; Todd Groome, Managing Director, Diversified Global Asset Management and Chairman, Alternative Investment Management Association; Mark Cutis, Chief Investment Officer – Global Special Situations, Managing Director's Office, Abu Dhabi Investment Council; Jean-François Boulter, Executive Managing Director, Chief Investment Officer, Aviva Investors France; Robert Parker, Vice Chairman, Credit Suisse Asset Management and Chairman AMIC.



Challenges of private banking in a global market with Gianluca Bisognani, Head of Private Banking, UBI Banca Group; Stefan Bichsel, Member of the Executive Board, Banque Cantonale Vaudoise; Stefan Kräuchi, Member of the Executive Board, Clariden Leu; Charles Hamer, Chairman, Private Banking Group, Association des Banques et Banquiers, Luxembourg and Chief Executive Officer, Crédit Agricole, Luxembourg; Paul Richards, Head of Regulatory Policy, ICMA.



The importance of global standards for market practice with Greg Tanzer, Secretary General, International Organisation of Securities Commissions; Onno Ruding, Chairman, Centre for European Policy Studies and Former Minister of Finance, The Netherlands; Yoshio Okubo, Senior Managing Director, Japan Securities Dealers Association; Rodolfo Fischer, Vice President of the Institutional Treasury, Banco Itaú S.A. and Chairman, ICMA's region for Latin America; Richard Britton, Consultant, ICMA.



Philippe Hildebrand, Vice-Chairman,
Swiss National Bank



Gillian Tett, Assistant Editor,
The Financial Times

ICMA repo documentation workshop

3 and 4 December 2009
London

The financial crisis has focused increased attention on secured lending and the use of the repo product in Europe. In response to demand from the market, the first ICMA Workshop on the Global Master Repurchase Agreement (GMRA) will run in December in London. During the two day workshop use of the standard documentation for the repo market will be covered in an operational context, including discussion of the legal issues, eg re-characterisation risk, enforceability of set-off in insolvency, governing law and conflict of law rules. Contractual architecture and the practical use of documentation, including case studies, will feature in sessions run by market practitioners and lawyers, giving insights into the everyday use of the GMRA 2000 and its associated annexes. An overview session on the functioning and trading characteristics of the international repo market is also included.

The workshop will be of value not only to legal advisers, lawyers and in-house counsel, but is also relevant to fund managers, regulators, compliance officers and risk managers. ICMA members are entitled to a substantial discount.

For more details please contact events@icmagroup.org

Educational courses

Financial Markets Foundation
Course (FMFC)
14-16 September 2009
London

Financial Markets Foundation
Course (FMFC)
21-23 September 2009
Luxembourg

Primary Market Certificate
Programme (PMC) Bahrain
25-29 October 2009
Bahrain

International Fixed Income and
Derivatives (IFID) Certificate Programme
25-31 October 2009
Sitges, Barcelona

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

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