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FAIR AND EFFECTIVE MARKETS REVIEW CONSULTATION DOCUMENT: ICMA RESPONSE

Introduction

The International Capital Market Association (ICMA) is a unique organisation which represents issuers, lead managers, dealers, investors and market infrastructure providers in the international capital markets. ICMA has around 470 members. They are based in the UK, across Europe and globally. ICMA has set standards of good market practice in the international fixed income market for almost 50 years. ICMA and the University of Reading also work together as ICMA Executive Education to deliver training courses for financial market practitioners.

ICMA supports the overall objectives of the Fair and Effective Markets Review, and is keen to help where it can. ICMA's response to the Fair and Effective Market Review Consultation Document focuses on specific questions relating to fixed income. In preparing its response to the Consultation Document, ICMA has consulted the ICMA Board and the following committees of member experts: the ICMA Primary Market Practices Committee, the ICMA Legal & Documentation Committee, the ICMA Corporate Issuer Forum, the ICMA Financial Institutions Issuer Forum, the ICMA Secondary Market Practices Committee, the ICMA Asset Management and Investor Council (AMIC) Executive Committee and the ICMA Regulatory Policy Committee. Collectively, these groups of experts cover the full span of the debt capital markets, from issuers, through intermediaries, to investors.

Summary

ICMA's response to the Consultation Document is intended to be read as a whole. Key points include the following:

- *Market microstructure:* A recent ICMA study suggests that, while there is scope for more trading activity to migrate to electronic trading venues, this is not a substitute for the liquidity provided through the traditional market-making model.

- From the point of view of corporate issuers, the treasury function is under a corporate governance obligation to manage its funding in the best interests of the company's business.

- Corporate borrowers today mostly choose to issue international corporate bonds on a syndicated book-built basis. Borrowers hire a syndicate of banks (lead managers) to help them collect orders and then to price the issue to demand.

- Borrowers, who are also financial market "end-users", have a strong interest in deciding which investors will receive bonds on issuance. An auction process does not enable a borrower to decide this.

- Lead managers seek to account for the interests of their borrower clients when allocating bonds on new issues. Borrowers may choose to rely entirely on their syndicate's proposal, suggest amendments or even elaborate their own allocation plan.

- Allocation is an art and not a science. Specific allocation considerations include early, proactive and useful feedback on what the transaction size/yield could be; track record of investing in the borrower, sector or type of issue concerned; likely holding horizon; and any apparent order size inconsistency with assets under management or prior investment history (which might indicate order inflation).

- It is relatively common today, though by no means universal, for lead managers to make deal statistics available to investors. These itemise the transaction's distribution by geographic segments and by investor type. However, going beyond that to the publication of individual allocations raises questions of statutory or contractual confidentiality in relation to both investors and borrowers that would need to be addressed (notably under MiFID client-facing rules).

- When considering alternative issuance processes, it is important to ensure they work in changing market environments and for under-subscribed bond issues as well as for over-subscribed ones.

- ICMA believes that there are significant risks in case well intentioned regulation inadvertently leads to undesirable effects on the functioning of fixed income markets.

- *Conflicts of interest and information flows:* Any conflicts of interest need to be appropriately managed (as required *inter alia* by MiFID) and confidential information also needs to be appropriately managed (as required *inter alia* by MiFID and MAD).

- *Competition and market discipline:* Eurobond borrowers can and frequently do change the lead managers that participate in their underwriting syndicates, without any investor or market reaction or comment (though borrowers do see an advantage in having relationship firms in the syndicate who already have a good understanding of their needs).

- The ICMA Primary Market Handbook was created to promote intra-syndicate efficiency in the context of Eurobond issues. It does so by non-exhaustively recognising industry consensus around salient good practice by ICMA member lead managers, notably regarding transparency and timeliness. The Handbook is not technically binding, and ICMA's Primary Market Practices Committee is not an enforcement body.

- *Benchmarks:* ICMA considers that much has already been done in a short space of time to improve the robustness of benchmarks and notes that further adjustments are already in train. It appears reasonable to believe that some time is now needed to allow all this to become more fully bedded down and any further action should only then be based upon observation of the new regime which leads to the identification of any remaining shortcomings.

- *Standards of market practice:* ICMA's experience is that, beyond formal rules and requirements, there is a highly valuable role that can be fulfilled by the market itself drawing up practice guides, which should fill in any gaps in the formal framework, and help to make clear how market activities can efficiently and effectively be conducted within the applicable formal framework.

- *Surveillance and penalties:* ICMA considers that there should be effective supervision of market participants and that this should reflect a consistent approach to the oversight of market behaviour. In this regard, ICMA is highly supportive of the role of IOSCO as a purveyor of internationally agreed market standards and considers that more should be done to leverage these as a basis for a common set of market standards.

Market microstructure

Q5: In fixed income, is greater use of electronic trading venues for a wider range of market participants possible or desirable? Are there barriers preventing a shift to a more transparent market structure?

1 Consultation with ICMA's members suggests that electronic trading in fixed income, and the use of single and multiple-dealer platforms, is steadily gaining traction, and this trend looks likely to continue. Electronic platforms offer efficiencies through functionality such as straight-through processing and automated trade matching, as well as through improved cross-market connectivity. The extent to which established and new platforms are able to deliver in terms of these efficiencies will determine their potential for market adoption.

2 In addition, feedback from our members suggests that more electronic platforms are likely to be developed, particularly in the European corporate bond space. This is largely as a response to reduced market liquidity as a consequence of more stringent banking and markets regulation reducing the capacity for banks' broker-dealers to provide a market-making service. While it is widely acknowledged that platforms by themselves are not a substitute for the liquidity that is provided by market-makers, they do provide the potential to enhance cross-market counterparty connectivity (including "all-to-all" trading) as well as supporting more efficient agency-style broking. Again, to the extent to which platforms are able to provide these efficiencies and that these efficiencies are desirable to market participants, it is reasonable to expect that these platforms will be adopted. In the repo product, for instance, ICMA has seen widespread adoption of electronic trading for the inter-dealer government bond repo market, improving efficiency, transparency and liquidity.

3 However, while there are certain efficiencies to be gained through the use of electronic trading venues, the broader use of electronic trading in fixed income markets should not be an end in itself, with greater transparency being the primary objective, both for on-venue and over-the-counter trading. MiFIR is likely to transform the fixed income secondary markets and provide this needed transparency, and it is equally likely that many market participants and venues will utilise electronic solutions in order to comply with MiFIR requirements. In this respect, there may be an increase in the adoption of electronic trading venues as a result of greater market transparency, rather than this being the driver of transparency.

4 There are of course limitations on the extent to which market participants wish for some fixed income products to trade exclusively through electronic platforms, particularly for less standardized or less liquid securities, such as corporate bonds. Already, ICMA observes that, while 40% of European investment grade corporate bond trades are executed on the three main electronic platforms (Bloomberg, MarketAxess, and Tradeweb), these tend to account for smaller trades (usually <€2 million), with the larger ticket sizes being executed between dealers and investors via phone). While there is clearly scope for platforms to support larger transaction sizes, ICMA would expect the direct dealer-investor model to persist in the case of corporate bond markets.

Furthermore, a number of products are not suitable for trading on electronic platforms, particularly less vanilla, more bespoke packages and structures.

5 Electronic platforms can also provide greater transparency and support price discovery, which may be desirable for many market participants. However, in the case of less liquid products, such as corporate bonds, this could be counterproductive, and the publicizing of a large transaction could add market risk to the dealer ("the winner's curse"). This will be one of the main challenges of MiFID II and its calibrations for pre and post-trade transparency. The growth and adoption of electronic platforms for fixed income products will be driven by market needs and the ability of platforms to service those needs. Establishing trading rules and best practice for electronic platforms (such as ensuring "firm" prices) will be important in supporting their popularity. However, this should be left to the market participants and platform providers to determine, rather than through regulation. Regulating or mandating e-trading runs the risk of unintended consequences or providing unfair advantages to some platforms. Regulation related to trading platforms also needs to be carefully considered. A good example of an unintended outcome is CSDR Article 5 (on T+2) which, unintentionally, potentially prohibits the trading of some securities financing transactions on electronic repo-trading platforms, and which is counterintuitive to the objectives of the Regulation.

6 In a recent ICMA study, *The Current State and Future Evolution of the European Investment Grade Corporate Bond Secondary Market: Perspectives from the Market*, a range of market participants, including sell side, buy side, and platform providers, were questioned about the electronification of the European corporate bond markets. The interviews suggest that, while there is scope for more trading activity to migrate to electronic trading venues, this is not a substitute for the liquidity provided through the traditional market-making model.

Q6: Is standardisation of corporate bond issuance possible or desirable? Should standardisation be contemplated across a broader range of fixed income products? How could that be brought about?

7 Although ICMA acknowledges that the syndicated world is much broader, including public sector agencies, supranational entities and some sovereign debt, ICMA's response focuses solely on corporate Eurobonds (ie international bonds), including both financial and non-financial issuers. In addition, ICMA's response does not address the possibility of standardisation across other fixed income products.

8 For frequent issuers, a smaller number of larger bonds would be easier logistically to trade and so might stimulate secondary market liquidity, and, potentially, reduce the cost of borrowing over time as deals attract more investors. However, it is possible that the problem of lack of bond liquidity primarily affects larger investment funds where there may be a liquidity mismatch between liabilities and assets. Many borrowers issue in response to reverse enquiry which allows investors to dictate structure, maturity and coupon payment dates to suit their investment profiles; liquidity is not an issue for these deals as they are not intended to be traded. For public deals, while liquidity is an advantage, it is not essential, as the market's continued growth makes clear.

9 From the point of view of corporate issuers, fundamentally, the treasury function is under a corporate governance obligation to manage its funding in the best interests of the company's business. Mindful of this, standardisation is not desirable for a number of reasons.

10 It is acknowledged in paragraph 5.1.2(8) of the Consultation Document that issuers need to be able to choose maturities and coupon structures to match their cash-flows. As well as needing to be

able to take advantage of *ad hoc* opportunistic funding, many issuers tend to borrow for a specific purpose and term, and cannot be tied to certain “one size fits all” parameters which do not match their intentions. It is fundamental that issuers have the freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for issuers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility. ICMA therefore considers that there would be significant reluctance to sacrifice this flexibility to raise capital market finance as required (subject always to market conditions), notwithstanding the intended stated benefits of standardisation.

11 While, owing to their funding profiles, very frequent, large issuers may in principle be qualified to issue on a standard schedule, to apply a broad brush approach to all issuers would be to disadvantage those smaller issuers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap issuers, but a push towards standardisation for very frequent, large issuers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

12 Issuers would seek compensation for any loss of flexibility by means of favourable pricing and liquidity for larger deal sizes: something which investors do not currently pay for and which would be hard to quantify given that liquidity is only one of many potential pricing factors. However, the causal link between the size of the deal and its liquidity remains unproven.

13 With regard to standardised maturities, large amounts of debt which become due for repayment on similar dates would concentrate refinancing risk for issuers, and could make it more difficult for investors to establish relative values between bonds with different tenors. The fundamental principle of supply and demand would be skewed in the direction of supply, leading to an economic imbalance for price and deal size (which in turn could affect the problems associated with liquidity that standardisation seeks to address). While this could be problematic for all issuers in terms of deal size and competitive pricing, in particular, if financial institutions find it economically inefficient, or are restricted in other ways from issuing, it would be difficult for them to manage their LCR ratios with certainty and predictability. A concentration of standardised maturities may inadvertently create volatility, which would not otherwise exist with staggered maturities which appeal to a variety of investors with different holding requirements and horizons.

14 Although interest payment dates on corporate bonds in the US are often aligned to mirror interest payment dates on US government securities (albeit issued on different dates, with long or short first coupons), such practice is not so usual in Europe. Therefore, in terms of market-related practicalities, consideration should be given to the market capacity to deal with potentially large activity bunching around the specified quarter days. Theoretically, standardisation of issuance dates, coupon payment dates and redemption dates would equate to an entire quarter’s worth of bond activity in one day – based on Bondradar data that 855 bonds were issued in 2013. This could therefore potentially equate to a large amount and, as already noted, would deprive issuers of the right to choose the most advantageous issuance time to match their requirements.

15 Further, with respect to standardisation, investors can already – to an extent – influence the shape of the bond markets in that inclusion in an index goes some way to dictate benchmark size (for instance, minimum size criteria in certain indices).

16 Paragraph 5.3.2 of the Consultation Document acknowledges: “Widespread use of a particular benchmark can lead to concentration of order flows around a fixing which can provide incentives for both front running and manipulation”. There is a question whether this could become self-fulfilling, as periodic standardisation would mean large amounts of rate fixings at similar times.

17 In a related context, when there are simultaneous redemptions of stock market index futures, stock market index options and stock options, there is generally an increase in the trading volume of options, futures and the underlying stocks, which occasionally increases the volatility of prices of related securities. It would be necessary to consider whether there would be a similar knock-on effect in terms of volatility or market disruption from the simultaneous mass redemption of bonds.

18 Standardisation would not necessarily substantiate the “intended” consequences *ex post*, leaving little incentive for issuers to change their issuance practice. Generally, fundamental changes in issuance practice would not be easy to achieve across the board, which makes it all the more important to show significant, proven benefits in order to spur adoption. In order to avoid any unintended adverse consequences that could inhibit the new issuance markets, it would be necessary to examine more closely the cause and effect between deal size, standardisation and liquidity and cost: the ultimate benefits, although ambitious, remain unproven and are therefore not necessarily clear to issuers.

Q7: Should the new issue process for bonds be made more transparent through the use of auction mechanisms, publication of allocations or some other route?

Background

19 Corporate borrowers today mostly choose to issue international corporate bonds (Eurobonds) on a syndicated book-built basis. Borrowers (often referred to as “issuers”) hire a syndicate of banks (lead managers) to help them collect orders to then price the issue to demand.

20 Following the financial crisis, there has been a marked increase in demand for Eurobond issues that has not been matched by the parallel increase in supply. This has resulted in order books for new issues being frequently heavily oversubscribed, with scores and sometimes hundreds of investors placing orders before books close. The simple laws of supply and demand mean that many investors are disappointed with their final allocation of bonds and in turn have come to question the allocation process itself.

Corporate borrower interest

21 Corporate borrowers seek not only to minimise their cost of capital, but also the ability to fund themselves flexibly in line with their underlying business needs (and see further ICMA’s response to Q6). In this respect borrowers seek to maximise their ability to access the bond markets at any time in the future. This involves building and maintaining investment relationships with a sufficient range of investors that are:

- able meaningfully to contribute to satisfying the borrower’s ongoing funding needs; and
- willing to act as committed (“buy and hold”) stakeholders in the borrower’s business in respect of the above and engage meaningfully in any reasonable restructuring discussions if

this unexpectedly comes to pass in the future (rather than immediately on-selling to a "vulture" fund).

22 Building and maintaining such investment relationships involves, in turn, ensuring good secondary market performance in current transactions so as not to disincentivise such investors from participating in future. If prices decrease or spreads increase (or "widen") in immediate aftermarket secondary market trading, this will cause buy and hold investors to regret having acquired their bonds in the primary market issue rather than in secondary market trading (all the more so if marking-to-market). Ensuring good secondary market performance also involves:

- receiving constructive feedback from potential investors as to desired issue parameters;

- careful selection of the investors that will receive bonds on issuance, so that there are sufficient sellers to provide the liquidity necessary for the transaction to complete its bedding down but not so many that the bond price or spread is adversely impacted.

23 Borrowers, who are also financial market "end-users", therefore have a strong interest in deciding which investors will receive bonds on issuance.

Auction mechanisms

24 An auction process by definition does not enable a borrower to decide which investors will receive bonds on issuance, since this is dictated by price. As corporate borrowers have a strong interest in deciding which investors will receive bonds on issuance, they generally choose not to issue by auction, even if an auction confers on the borrower some pricing advantage for the transaction in question. (But see further below.)

25 Auctions are effective for those, primarily sovereign, borrowers who already have an established presence in the market, are well-understood by investors and have multiple bond issues of different maturities already trading in the secondary market providing reference points for pricing. Such borrowers often "tap" or re-open existing bonds and tend to issue frequently and with large issue sizes. The fact that sovereign borrowers do not need to produce approved offer documents for their bond issues also contributes to the appeal of the auction process. This approach may not be appropriate for smaller, less frequent borrowers as investors are less familiar with their name and credit story, lack pricing reference points in the secondary market, and less frequent borrowers (unlike sovereign borrowers) need to have an approved prospectus before making any public offer.

26 Auctions may actually produce an execution disadvantage for such smaller, less frequent borrowers compared to book-built syndications (which intrinsically involve active marketing). This is because the above lack of market familiarity and references may well result in less investor interest (given auctions do not involve active marketing), moving supply and demand (and so pricing) dynamics against borrowers. Furthermore, auctions work well in liquid markets where bonds are frequently taken down by market makers, who need several days' advance notice to prepare their positions ahead of transactions. This reduces borrower's timing flexibility, as they are less able to react to adverse market changes on the day of the transaction and may thus have to accept worse pricing or cancel transactions – increasing market failure rates. In contrast, for book-built syndications, borrowers can decide in the morning to launch (and price) transactions that same day.

27 It is interesting to note that, not only do the less established (eg emerging market) sovereign borrowers often choose to issue internationally on a syndicated rather than auction basis, but some established borrowers like the UK's Debt Management Office have also done so in recent years.

Other possible mechanisms

28 "Retention" transactions used to be prevalent in the Eurobond markets, but are rare today. They involve the borrower setting the price and size of a new issue prior to it being offered to potential investors. Each manager in the syndicate receives a fixed amount of bonds which it then seeks to sell to investors. The advantage of this approach for the borrower is guaranteed funding at a specific level as each of the managers is obliged to purchase their portion of bonds, irrespective of whether they have investors prepared to buy them. Unsold bonds remain on the books of the individual manager. However, this tends to involve higher fees as a result, and furthermore there is no flexibility in the pricing or size of the deal – for example due to external market conditions or based on feedback from investors – as these details are fixed before bonds are offered to potential investors. From the perspective of certain investors, this may be an advantage, particularly if they are clients of several of the managers in the syndicate and able to place orders with each of them in order to acquire a larger portion of the new issue. By contrast, smaller investors may be disadvantaged. Furthermore, the borrower has no transparency over the order book (there is no combined order book) and, in particular, the borrower has no say in deciding which investors receive bonds.

29 Within the syndicated book-built context, allocating orders *pro rata* to their size risks encouraging order inflation and so ballooning order books. A hard limit on the maximum amount that an individual investor can be allocated might seem appealing when there are many other investors wanting the same bonds, but less so if the deal is not performing as well. Trying to fix a cap and floor on the percentage differential between the highest and lowest allocation might also encourage order inflation. Would it be fair to apply a fixed percentage allocation to all orders in an over-subscribed deal? Or would that disadvantage investors with genuine long-term demand? Simply following a "first come, first served" approach might favour investors in a particular time zone at the expense of others. Might this concentrate the bonds into the hands of investors in a particular region? Or a particular type of investor? How would this impact secondary market liquidity? These considerations need to be weighed in light of the borrower interest considerations outlined above.

Current allocation processes

30 Lead managers seek to account for the interests of their borrower clients when allocating bonds on new issues. They do this on the basis of any specific borrower priorities (eg trying to expand its investor base into new sectors or geographical regions) and otherwise on the basis of the above generic borrower interests as materialised by their internal allocation policies and procedures (and, of course, regulatory selling restrictions). The lead managers in a syndicate will on this basis propose an allocation to the borrower, which can then review it against the orders received. Borrowers may choose to rely entirely on their syndicate's proposal, suggest amendments or even elaborate their own allocation plan without syndicate involvement or advice – depending on their willingness and ability to engage in the process. But lead managers always show the book to borrowers (ie issuers) – all have processes in place that insist on this – and issuers have the final say since it is their deal. Borrowers can invest considerable time and effort in investor relations and, where there has been a roadshow for a transaction, borrowers may be keen to see to what extent that has resulted in actual orders from the investors involved.

31 Allocation is an art and not a science. Specific allocation considerations include early, proactive and useful investor feedback on what the transaction size/yield could be, track record of investing in the borrower, sector or type of issue concerned, likely holding horizon, and any apparent order size inconsistency with assets under management or prior investment history (which might indicate order inflation). Such factors need to be considered in constantly changing market dynamics, often involving subjective judgments. Prescriptive and detailed rules are unsuitable to overcome these challenges. Lead manager allocation policies and procedures accordingly seek to highlight relevant considerations and cannot prescribe strictly mechanical approaches. Explanatory Note XIII (revised 2012) in Appendix B of Section 6 of the ICMA Primary Market Handbook discusses some of the salient considerations further – these are reproduced below for ease of reference. The 2004 *Guidance on Policies and Procedures for Managing Conflicts of Interest in the Context of Allocation and Pricing of Securities Offerings*, issued by ICMA's predecessor organisations and the British Bankers' Association in the context of the UK's pre-MiFID regime, may also be of interest by way of historical reference as it influenced many policies at the time.

<< ALLOCATION

13. Orders on a new issue may exceed the issuer's initially planned size. In some cases, the issuer may decide to increase the issue size, but, notwithstanding this, orders may even exceed any such increase. Issuers generally have very clear objectives for the amount they wish to borrow in advance of any deal announcement. These views are unlikely to be materially changed by the size of an orderbook. The challenge for bookrunners is firstly to reconcile (e.g. identify duplication) and consolidate the various orders (as books are generally built through several participating banks), secondly to establish true demand (as opposed to apparent demand) and thirdly to allocate the transaction in as efficient and fair a way as possible.

14. On the first aspect, efficiencies are being sought through increased automation with bookrunners increasingly connecting their orderbook management systems in a manner enabling unique investor identification.

15. The second aspect is complex. An investor might place an order larger than its true internal demand (order 'inflation') if, for example, it (i) anticipates that its order will be reduced on allocation because of oversubscription, (ii) overestimates demand that it was unable to confirm internally prior to placing its order, or even (iii) anticipates particularly strong demand by other investors and so expects to liquidate part of its allocation in initial secondary trading to crystallise the initial issuance premium ('flipping'). In this respect, it seems that some investors are unable or do not wish to inflate their orders, others appear to do so frequently, and yet others may do so just occasionally according to market conditions. Leaving aside how order inflation might be treated under applicable market abuse regulations, bookrunners may well

apply a discount factor to, or even entirely exclude on allocation, orders they view as being potentially inflated (bookrunner views in this respect will *inter alia* account for previous experience with specific investors). Investor transparency to bookrunners is an important factor in avoiding mischaracterisation in this respect. In particular, investors may find it helpful to explain orders that (i) appear to be out of proportion compared to orders on previous transactions or to apparent assets under management, or (ii) are placed or increased at a relatively late stage during the launch process (and so appear to be based on perceived levels of demand rather than on transaction fundamentals). This later aspect is further complicated in that delayed demand may be due, as mentioned above, to investors legitimately needing to confer internally with colleagues managing sub-funds.

16. The third aspect is less complex, though 'scrubbed' final orderbooks are, despite the bookrunners efforts, not certain to be entirely inflation free. Aside any preference being given to specifically targeted investor groups (for example where an issuer is seeking to diversify its investor base), some preference may be given to long-term investors that (i) have shown interest in the transaction, for example through actively participating in roadshows, investor update calls, etc., and/or (ii) have a history of investing in the issuer or its sector, and (iii) do not have a history of flipping. Helpful participation in the pre-sounding process may be rewarded by some prioritisation during allocations, though this is limited and seems to be insufficient for many investors to agree to being pre-sounded. A commercial relationship with other parts of bookrunners' firms is not a relevant consideration, being in any case restricted by regulation. Bookrunners frequently discuss their general allocations procedures with individual investors. >>

32 The Consultation Document states that some may suggest that lead managers grant better allocations to their "favoured" investors. In this respect it should be noted that practices such as laddering, spinning and *quid pro quo* arrangements have long been considered abusive and were previously stated as unacceptable by the 2004 Joint Guidance mentioned above. The only nuance is that some investors have more bargaining power as discussed below, but this is not "favouritism".

33 Some large market participants (perhaps 15-20 investors globally) benefit from legitimate bargaining power as borrowers naturally have an interest in such investors participating in their transactions for the reasons noted above. Large investors also contribute more to the transaction by providing certainty and helping with price formation. Consequently smaller investors may indeed receive higher percentage allocations on transactions where larger investors are less involved, but this does *not* mean that the transaction is "expected to perform poorly". The focus here is appropriate initial pricing, which depends on accurate investor input as noted above. If small investors contribute less efficiently to the price formation process (eg by placing orders "at reoffer" or not revising their orders in step with updated price guidance), then that increases the risk that the bond will not be optimally priced, thus leaving scope for subsequent "poor" performance (be it spread widening to initial investor disadvantage or excessively tightening to initial investor advantage but potential borrower disappointment). The question is one of "uncertainty" rather than "expectation". Interestingly, one (admittedly larger) investor was quoted in a June 2014 press article (*The Big Bond Squeeze*), noting:

“We've seen massive growth in the corporate bond market over the last decade including the recent presence of what are often referred to as 'tourist' investors in this segment. So the conundrum is defining whether a fair allocation should imply a flat percentage across every order [Note: one of the detailed/prescriptive approaches alluded to above], or whether smaller investors with weaker control environments might only be interested in a quick turn while larger investors have genuine long-term demand and so merit preferential allocation."

Publication of allocations

34 It is relatively common today, but by no means universal, for lead managers to make deal statistics available to investors. These itemise the transaction’s distribution by geographic segments and by investor type. However, going beyond that to the publication of individual allocations raises questions of statutory or contractual confidentiality in relation to both investors and borrowers that would need to be addressed (notably under MiFID client-facing rules). It is far from clear that either of the parties involved would be willing to waive any confidentiality rights they have – investors may not want the world to know what their securities’ holdings are if they consider their legitimate freedom to trade might be impinged and borrowers might have concerns similar to a manufacturer being asked to publish its customer base.

35 A distinct consideration is that, while lead managers work to produce an appropriate allocation proposal for their borrower clients and should be able to explain any individual allocation decision to their regulator on request, they cannot logistically enter into a debate with each of the up to 500-odd investors in an individual order book as to the relative merits of each allocation.

Market dialogue

36 Various investors have seemed at various times to misunderstand the syndication process (including as to allocations). ICMA undertook, and is continuing, to hold regular meetings between investors, syndicates and borrowers to promote a better understanding of the process and the needs of all parties in this respect. Explanatory Note XIII mentioned above was originally published in furtherance of this aim.

37 ICMA has also addressed aspects relating to allocations and the new issue process more generally in its February 2011 response to a European Commission Consultation Paper on the review of MiFID and its August 2014 response to an ESMA Level 2 Consultation Paper on MiFID II/MiFIR. (In this last respect see further also ESMA’s advice on underwriting and placing published in December 2014 as part of ESMA’s Final Report on its Technical Advice to the European Commission on MiFID II and MiFIR.)

Other aspects

38 The Consultation Document notes in passing that US firms reportedly mis-structured or misrepresented securitisation transactions to investors. In this respect it is worth recalling there has been much press commentary about the unfortunate lack of clarity around such reports given the private nature of the regulatory settlements involved.

39 The Consultation Document also notes in passing that “banks often package bond issuance with other services in bundled transactions, offering clients reduced fees for a package of services. For example the issuance of new debt often prompts the creation or purchase of related swaps and derivative”. In this respect, it is worth noting that swap transactions are entered into in parallel to

bond issues and are usually offered across the market at competing rates (borrowers may well source their hedging needs away from the lead managers).

Conclusion

40 The Eurobond market is, and should be, about the financial economy serving the real economy – not the other way round. When considering alternative issuance processes, it is important to ensure they work in changing market environments and for under-subscribed bond issues as well as for over-subscribed ones, though this seems unlikely in 2015 (not least because of expected central bank purchasing intervention) according to press reports (see Bloomberg's *The $400 Billion Bond Mismatch Keeping Bears at Bay Endures*). Current investor disappointment on allocations might ultimately only be cured by an abatement of the significant imbalance between supply and demand for Eurobond issues. ICMA will however continue its engagement on this topic in the meantime.

Q11: Are there any areas of FICC markets where regulatory measures or internationally coordinated regulatory action are necessary to address fundamental structural problems that exist?

41 ICMA prepared a paper for policy makers, published on 8 April 2013, entitled *Economic Importance of the Corporate Bond Markets*. This outlined why corporate bond markets are so important for economic growth, for investors, for companies, and for governments, around the world; and why it is therefore essential that laws and regulations that affect them avoid any unintended adverse consequences that could inhibit those markets. In response to widespread concerns that the cumulative impact of current and proposed regulatory reform threatens to undermine core aspects of the economic functions of trading in the European repo and fixed income markets, ICMA then produced a paper, published on 29 October 2013, entitled *Avoiding Counterproductive Regulation in Capital Markets*.

42 Conclusions from this latter paper bear repeating in context of this FEMR consultation question.

- ICMA considers that in order to deliver policy objectives and maintain the consistency and momentum of regulatory reform, policy makers, central banks, regulatory authorities and market participants need to work collectively to identify and resolve the undesirable inconsistencies (that are identified in Section B of the report).

- Authorities and markets need to consider each measure individually on its own merits. But it is also necessary to consider how these measures and proposals, and perhaps other relevant policy initiatives, interact together.

- Both of these analyses, and the consequent actions, need to be informed by a collective understanding as to how far the problems identified can be solved at regional or national level, or whether they may need to be addressed by global institutions.

- Authorities and markets may need bold and imaginative solutions, combining regulation with non-regulatory market discipline, to achieve practical, consistent, and directed policy that can help to limit future weaknesses as well as to avoid repeating past failures, and so support mutually accepted objectives of consistent and sustained regulatory reform, financial stability, and renewed growth.

43 A core theme running through ICMA's October 2013 paper was the importance of collateral and the extent to which changes to financial regulatory rules risk impeding the functioning of the European repo market, which serves as a primary channel for the circulation of collateral. In light of this, a further ICMA European Repo Council paper, *Collateral is the New Cash: the Systemic Risks of Inhibiting Collateral Fluidity*, was published on 3 April 2014. This describes the increasing importance of collateral and how it effectively underpins the functioning of capital markets which provide the basis for economic growth. It calls for regulators to consider the impact of financial regulation on the movement of collateral, highlighting the potential systemic risks of inhibiting collateral fluidity and the negative impact this could have on the stability and efficiency of capital markets.

44 Conclusions from this ICMA European Repo Council paper include the following:

- Even with more stringent regulation and greater demand for collateral, so long as collateral is still free to move around the system, it is possible to feel comfortable with the assumption that financial markets will continue to function, even if somewhat inefficiently, at least under benign conditions.

- However, if collateral fluidity is inhibited, this poses a risk to the overall functioning of the markets, which will become more pronounced under conditions of market stress. This could not only freeze funding and capital markets, but would have serious repercussions throughout the whole economy.

- If banks find it economically inefficient, or are restricted by regulation from supporting the critical functions of sourcing, pricing, managing, and mobilizing collateral, and the infrastructure is not in place for the efficient mobilization of collateral, then the basic intermediation roles of banks and financial markets – that of maturity, risk, and credit transformation – would be undermined. For all the good work and best intentions of financial regulation, this would be embedding systemic risks.

- Sound regulation is essential for the efficient and stable functioning of the global funding and capital markets that support our economies. So is collateral. In this respect, regulation should not only avoid inhibiting collateral fluidity, but, where possible, it should aim to enhance it.

45 ICMA believes that the aforementioned papers have clearly articulated the importance of efficient and effective fixed income markets and identified that there are significant risks in case well intentioned regulation inadvertently leads to undesirable detrimental effects on the functioning of fixed income markets. ICMA calls for more work to identify and remediate such problems, particularly taking into account the cumulative effect of regulations. From a European perspective this will be important foundation building for Capital Markets Union; and more generally it is of fundamental importance to underpin investment flows, economic growth and the creation of jobs.

46 Furthermore, it is important to recognise that these concerns cross both national and EU boundaries. An important contributing factor in achieving the full benefits that can be gained from capital markets lies in their global nature. Avoiding problems at this level requires meaningful coordination of regulation across international boundaries and the ICMA is pleased to note the efforts which have been being made to develop workable solutions for third country interaction. Nevertheless, it is clear that there is a vast amount of international coordination required to resolve

differences, of both substance and timing, before outcomes are achieved which will positively assist, rather than impede, international investment. The work of IOSCO's Cross-Border Task Force, which is supported by ICMA and others through the Cross-Border Regulatory Forum, is a positive step which needs to be energetically followed through and built upon.

Conflicts of interest and information flows

Q12: Where do potential conflicts of interest arise in the various FICC markets, and how do they affect the use and potential abuse of confidential information, both within and between firms?

47 Any conflicts of interest need to be appropriately managed (as required *inter alia* by MiFID) and confidential information also needs to be appropriately managed (as required *inter alia* by MiFID and MAD).

48 The Consultation Document identifies "securing benefit to favoured parties by a firm underwriting a debt offering" as an example of "forms of information sharing clearly constitute[ing] market misconduct". This seems odd since it does not necessarily imply the sharing of information. If what is envisaged here is that a benefit is secured by a sharing of information, then the laws applicable to inside information and client confidentiality might be relevant (and in this respect see references to MAD/MAR and MiFID/MiFID II *infra*). In relation to such "favoured parties", see further ICMA's response to Q7.

49 Generally speaking, ICMA has addressed aspects relating to:

- conflicts of interest in the context of allocations in its February 2011 response to a European Commission Consultation Paper on the review MiFID and its August 2014 response to an ESMA Level 2 Consultation Paper on MiFID II/MiFIR; (in this last respect see further also ESMA's advice on underwriting and placing published in December 2014 as part of ESMA's Final Report on its Technical Advice to the European Commission on MiFID II and MiFIR;)

- confidentiality of inside information most recently in its January 2014 response to an ESMA Level 2 Discussion Paper on MAR and in its October 2014 response to an ESMA Level 2 Consultation Paper on MAR.

Q13: How can the vulnerabilities posed by such conflicts be reduced? Are existing internal structures and control procedures sufficient? Where they are not, are further internal management controls required (such as better trading floor design and/or closer monitoring of electronic communications within and between firms) or is more radical action required to remove conflicts altogether?

50 Generally, existing rules, notably MiFID and MAR, require firms to have appropriate controls in place.

51 More specifically in terms of "seating arrangements"', lead manager bond syndication desks have for some time indeed been increasingly segregated from secondary trading desks. This has not only been on different floors, but ranged from being in a segregated section of the trading floor to even, in a few cases, being in different buildings. While this can indeed be seen as bolstering controls on inappropriate information flow from "public" to "private" sides, it can also reduce the effective generic "market colour" flow the other way (thus incrementally adversely affecting syndicate ability to effectively price and allocate transactions). Physical segregation aside, lead manager firms will

also have in place policies, and training, monitoring and enforcement processes, relating to information flows.

Competition and market discipline

Q14: Is there a relationship between the level of competition in FICC markets globally and the fairness and effectiveness of those markets? What risks are posed by the increase in concentration seen in some FICC markets? In answering this, please have regard to the geographical scope of any relevant markets.

52 The Consultation Document's note that "some FICC markets are intensely competitive, demonstrated by the extremely thin margins [...], the level of innovation, and the wide range of instruments available" seems generally accurate – at least in relation to the underwriting of new Eurobond issues. ICMA understands there is strong underwriter competition. In this respect ICMA notes a quote (in GlobalCapital's June 2014 Special Report, *Financing Corporates*) by Stéphane Tortajada, head of group finance and investments at Electricité de France, that: "There are a very large number of banks and the competition between them is very tough."

53 There may indeed be relatively "high barriers to entry" in relation to Eurobond underwriting – notably regulation (as the Consultation Document acknowledges). However "degrees of concentration" seem low, with the Dealogic 2013 Bookrunners of all international bonds league table (as published in the 30 January 2014 issue #1339 of the then Euroweek magazine) indicating (i) the highest market share as 8.76%, (ii) seven further market participants with market share between that and above 5% and (iii) 19 market participants with market share of 1-5%.

54 Eurobond borrowers can and frequently do change the lead managers that participate in their underwriting syndicates, without any investor or market reaction/comment (though borrowers do see an advantage in having relationship firms in the syndicate who already have a good understanding of their needs).

55 ICMA recently addressed the competition aspects around Eurobond underwriting in:

- its October 2014 response to an FCA call for inputs in relation to its Wholesale Sector Competition Review; and
- its August 2014 response to an ESMA Level 2 Consultation Paper on MiFID II/MiFIR. (In this last respect see further also ESMA's advice on underwriting and placing published in December 2014 as part of ESMA's Final Report on its Technical Advice to the European Commission on MiFID II and MiFIR.)

Q17: How effective is market discipline in enforcing sound market practices in each of the key FICC markets? What could be done to strengthen it?

56 In terms of the primary Eurobond markets, the ICMA Primary Market Handbook was created to promote intra-syndicate efficiency in the context of Eurobond issues. It does so by non-exhaustively recognising industry consensus around salient good practices by ICMA member lead managers, notably regarding transparency and timeliness. The Handbook is not technically binding (one of the relevant considerations in its past competition law vetting), but operates rather on the basis of recommendations that entitle other syndicate members to express reasonable reproach where

recommendations are not followed. This is effective within its limited remit. But ICMA's Primary Market Practices Committee is not an enforcement body, and the non-binding nature of the ICMA Primary Market Handbook is one of the criteria in the competition clearances that ICMA has received. (For more detail on the ICMA Primary Market Handbook, see ICMA's response to Q32.)

57 In terms of the secondary bond markets, one consequence of the current structure of the secondary market is that dealers play a central role. However, two current trends are changing market structure and the dealers' position. First, the reduction in the commitment of assets to the provision of liquidity ("balance sheet commitment" in the jargon) reduces the contribution of dealers. However, it may strengthen their position *vis-à-vis* individual clients and the allocation of balance sheet is, properly, the decision of the individual dealer bank. A second consequence of the reduction of balance sheet commitment is the rise of brokers, as investors use skilled agents to seek out liquidity or "naturally" occurring countervailing flow. In time, these dealers could provide part of the solution to the need for market discipline and high standards. Ultimately, it should be for institutional investors to shape the market to their needs; but their track record suggests that they are not necessarily well fitted for this role.

58 The second development is transparency. Changes to price transparency are coming to the fixed income markets in Europe for commercial and regulatory reasons. While it has long been recognised that, broadly, those with an interest could obtain the necessary data, there have recently been a number of initiatives to bring greater transparency to corporate bond trading, sometimes building on the model of the government bond market. The commercial reasons for this include (i) greater demand by investors for price information, partly for reporting and regulatory purposes; (ii) demand for market data from brokers, as they become more important than they were; and (iii) a recognition among the banks that "it pays to advertise", as the aggregate provision of liquidity falls and inventories sink. One way to do more with less is to make better use of available information; and improving the quality and availability of information is a supplementary strategy.

59 On the regulatory side, it is important to remember that MiFID II will not come into effect for around two years; and that it may, perversely, hamper the development of initiatives in the short term, as uncertainty over the detail of the ultimate requirements introduces risk. Nevertheless, there is evidence that established suppliers to the market (Thomson Reuters, Bloomberg, Market Axess, TradeWeb, Bondmatch and others) as well as recent entrants (Algomi, BondCube and others) are preparing new or enhanced products and services to sustain the market. Together, these developments have the potential to strengthen market discipline and promote more effective competition between market participants, particularly but not only the intermediaries.

60 ICMA sees no immediate need for additional intervention by the authorities at this stage. However, a more proactive and visible role for supervision, particularly but not only market supervision, could strengthen the hand of both those seeking to operate to high standards and victims of bad behaviour.

Benchmarks

Q21: Do current domestic and international initiatives by industry and regulators to improve the robustness of benchmarks go far enough, or are further measures required?

61 In overall terms, ICMA considers that:

- the authorities' focus in reforming indices should be on regulating the governance of the process for setting indices to ensure that it cannot be manipulated and to prevent market abuse;

- it is important that any reform of rate-setting processes for existing transactions referenced to indices does not disrupt the international capital market;

- it is for the market to choose, as a commercial matter, which reference rates to use for new transactions;

- if powers to compel participants in financial markets to make submissions to benchmarks exist, they should only be used as a last resort, and where there is a significant risk of widespread disruption to the international capital market; and

- any market abuse should be covered by appropriate market abuse regulation.

62 These overall ICMA views are supported by more detailed observations, as articulated in ICMA's 27 November 2012 response to the European Commission's Consultation Paper on the *Regulation of Indices,* which itself includes a full copy of ICMA's 7 September 2012 response to *The Wheatley Review of LIBOR*. More particularly, the second of the above mentioned bullet points relates to ICMA's concern to maintain the contractual continuity of major market benchmarks; and is a specific example of the broader regulatory concerns articulated in ICMA's response to Q11 of this consultation.

63 ICMA considers that much has already been done in a short space of time to improve the robustness of benchmarks and notes that further adjustments are already in train. It appears reasonable to believe that some time is now needed to allow all this to become more fully bedded down and any further action should only then be based upon observation of the new regime which leads to the identification of any remaining shortcomings. In case further action is to be taken, it should be developed in a manner which duly respects the five overall points which have been restated above.

Q22: What steps could be taken to reduce the reliance of asset managers and other investors on benchmarks?

64 While individual firms are better able to share their own experience of using, and relying, on benchmarks, these are some general comments about the use and reliance on benchmarks.

65 It is important to remember that it is often not the funds or fund managers who choose what benchmarks to follow, but a preference built in by the asset owners (ie institutional or retail investors). Asset owners find value in using benchmarks, both to express their general wishes to their managers and to ensure all their managers have the same guidance and can be directly compared. The value of comparison is important: any asset owner with more than one manager executing the same mandate will want to compare them on a like-for-like basis, and tying them both to the same external benchmark is a recognised and efficient way of doing this.

66 The Consultation Document notes the continued widespread reliance on benchmarks in recent years despite the flaws uncovered in LIBOR and other benchmarks. The use of specific benchmarks,

for example the WM Reuters 4 pm FX fix, as highlighted in Section 5.3.2 paragraph 5, is necessary to ensure valuation and reduce tracking performance of certain funds in fixed income markets.

67 When it comes to investment funds, in Europe funds are highly regulated financial products through European legal frameworks in the UCITS and AIFM Directives. Asset managers are users of rate benchmark and market indices when managing portfolios on behalf of their clients. Indices are either used as a target for index-linked funds, such as passive investment funds and exchange-traded funds (ETFs), or as an evaluation tool of an active manager's performance. Investors have no direct access to the benchmark setting processes and are not able to control their outcome nor are they able to manipulate it, and nor do they use them to price financial instruments – the value of a fund for example is determined by the value of the assets held, not by the value of the index.

68 There are some existing rules already governing the use of benchmarks by asset managers. UCITS managers already follow the conditions in the ESMA *Guidelines on ETFs and Other UCITS Issues*, which stipulate that only transparent indices are permitted for UCITS to use as a benchmark. These transparency requirements cover calculation, rebalancing methodologies, and constituent elements of the index and their respective weightings. As for the underlying investors investing in funds, when an index is used as a performance evaluation tool, this is disclosed in advance in the UCITS key investor information document (KIID).

69 ICMA considers that trying to regulate indices through their use by investors is not the most effective way to deal with inefficiencies and potential for manipulation in benchmark setting processes. What is important to remember is that benchmarks are very useful tools in fixed income markets owing to the very lack of transparency and valuation challenges as acknowledged by Section 5.3.2, paragraph 5.

70 Furthermore, the large amount of money following popular benchmarks creates efficiencies around the benchmark, which could be lost if investors were forced away from benchmarking. ICMA recognises that the prevalence of benchmarking risks forcing clients to choose from a restricted set of portfolios that may not exactly match their situation, but the benefits of this approach include ease of use, transparency, and external measurement of performance.

71 ICMA is not clear what asset owners would use instead of benchmarks or whether they would be willing or able to be more bespoke in their own analysis and instructions to managers. If there was a drive for the asset management community to reduce the use of benchmarks, the asset owners would probably resist this and would likely want to put something similar in their place.

72 It is important that any reform of rate-setting processes for existing transactions referenced to indices does not disrupt the international capital market and, fundamentally, it should be for users to choose, as a commercial matter, which reference rates to use for transactions or fund tracking purposes.

73 There is already a significant amount of new regulatory requirements relating to benchmarks: in the UK, at EU level and internationally. ICMA considers that the focus should be on allowing these requirements to bed down before deciding if more are needed.

Standards of market practice

Q27: Are existing sources of information regarding standards of market practice across FICC markets globally: (a) already sufficiently clear (or will be once current regulatory reform has

concluded); (b) sufficient, but in need for clearer communication or education efforts; or (c) not sufficiently clear, requiring more specific guidance or rules to provide more detail or close genuine gaps?

74 Box 7 in the Consultation Document describes a series of "Reported uncertainties over FICC market practices". While not offering an opinion on the merits, or otherwise, of each of the points raised in Box 7, ICMA is not surprised that reports of uncertainties are found and considers that this is an inevitable challenge which will continue to be faced. Even for a native speaker of a language listening to a conversation or reading a text, it is commonplace to discover that the very same words can convey different meaning to different listeners/readers. The following further observations in respect to the three sub-sections of this consultation question take this challenge as a given and seek to help the consideration of how best the challenge can be met.

- Across fixed income markets globally there are multiple existing sources of information regarding standards of market practice. Whilst the promulgator of each standard will, no doubt, have sought to convey sufficiently clearly their intent, it is highly likely that room for interpretation will remain to some degree. Particularly since there are many newly formulated standards of market practice, which in a lot of cases have been hastily developed in response to identified shortcomings, there will have been little time to evolve common understandings and interpretation precedents. So ICMA expects that there is unlikely to be sufficient clarity simply by virtue of a known and accessible source from which to obtain the relevant standard.

- Given this expectation, ICMA perceives that there is an essential role for efforts to clarify communication and for ongoing education. Clarification can helpfully be provided through mechanisms such as the publication of supporting interpretative guidance and of "questions and answers". Coupled with an ongoing process of review and improvement in respect of the underlying texts, this can help to ensure that, over time, the applicable texts become more clearly expressed and better understood. Alongside this, ICMA firmly believes that education has an essential role to play; and for 40 years the delivery of market focussed education, for the benefit of market participants, has been a core part of ICMA's services. Particularly given the continued intake of new staff and the evolution of standards over time, there is a continuing need for appropriate education, and it should be a requirement across all markets that there are relevant minimum standards in place, to give assurance that those working in the markets are adequately trained.

- ICMA's experience is that, beyond formal rules and requirements, there is a highly valuable role that can be fulfilled by the market itself drawing up practice guides, which should fill in any gaps in the formal framework; and help to make clear how market activities can efficiently and effectively be conducted within and respectfully of the applicable formal framework. The identification of such market practice has been another core part of ICMA's services over recent decades, with the most prominent examples being enshrined within the ICMA Primary Market Handbook and the ICMA Secondary Market Rules and Recommendations. (See our response to Q32.) Even then, what is written (whether in rules and regulations or in supplementary guidance and industry practice guides) cannot, and should not, be expected to cover all eventualities and there will, accordingly, always be a need for some aspects to be left for determination by practitioners' common sense.

Q28: Box 7 on pages 36-37 discusses a number of uncertainties over FICC market practices reported by market participants, including: the need for greater clarity over when a firm is acting in a principal or an agency capacity; reported difficulties distinguishing between legitimate trading activity and inappropriate front-running or market manipulation; and standards for internal and external communication of market activity. To the extent that there are uncertainties among participants in the different FICC markets over how they should apply existing market standards in less clear-cut situations, what are they?

75 The Consultation Document refers generally to "market sensitive information". It is important to be clear what kind of confidentiality or other sensitivity is involved in such cases, as information can be protected for a variety of different reasons – further to insider considerations, MiFID client confidentiality, other client confidentiality (such as bank secrecy), contractual confidentiality, data protection rules etc.

76 Regarding market uncertainty around inappropriate front-running or disclosing inside information, a key cause (at least in relation to Eurobond issuance) has been regulatory enforcement that seems to be mis-interpreting the MAD definition of inside information. This has unfortunately been recently confirmed in the UK courts in the Hannam case, albeit only as a first instance judgment. The MAD test itself seems clear on its face that inside information inter alia involves non-public information being "likely to have a significant effect on [...] price[...]" (Directive 2003/6/EC, Art. 1.1). However, FCA enforcement seems to have sought historically to minimise price effect, focusing instead on mere investor "interest" – which arguably could include *all* non-public information that is within the minds of senior management. The ECJ Daimler judgment however reaffirmed price relevance, but Hannam then interpreted the above "likely to have a significant effect on price" to mean merely that a "non-trivial" price impact be a "realistic prospect"/not "fanciful" (ie merely "plausible").

77 Insider regimes were created as corollaries to borrower transparency requirements – the social compact being that, in return for approaching the public for funding, companies must publish all price-forming information or keep it confidential if delaying for permitted reasons. The reason insider regimes need to focus on enforcing this confidentiality is to prevent the enrichment of insiders at the expense of others: hence the relevance of price sensitivity to the definition of inside information.

78 Distinctly, ongoing legislative work on the new MAR may impose additional uncertainty by, so far, purporting, in the context of market soundings, to impose "safe harbour" conditions on the disclosure of information that is not inside.

79 Generally speaking, ICMA has addressed aspects relating to confidentiality of inside information most recently in its January 2014 response to an ESMA Level 2 Discussion Paper on MAR and in its October 2014 response to an ESMA Level 2 Consultation Paper on MAR.

80 Transaction or product "suitability" has long been the subject of detailed coverage under MiFID.

Q32: What role can market codes of practice play in establishing, or reinforcing existing, standards of acceptable market conduct across international FICC markets?

81 The Consultation Document refers to "dated voluntary market codes lacking formal enforcement powers" and to a perception that existing voluntary market codes are "too numerous,

too focused on technical market issues rather than market practices, too dated, too legalistic to have traction with FICC traders, or lacking in enforcement powers".

82 ICMA maintains two documents that might be perceived as "market codes": the [ICMA Primary Market Handbook] and the [ICMA Secondary Market Rules and Recommendations].

83 The ICMA Primary Market Handbook was created to promote intra-syndicate efficiency in the context of Eurobond issues. It does so by non-exhaustively recognising industry consensus around salient good practices by ICMA member lead managers, notably regarding transparency and timeliness. This is therefore a normative rather than formative process. The ultimate aim is to ensure that managers invited to join new issue transactions on the market's typically abbreviated time frames are able to do so with a legitimate expectation of how such transactions will unfold unless they are notified otherwise – this is necessary to ensure that syndicates operate effectively as a team on behalf of their borrower clients. The Handbook is not intended to solve wider market grievances or imbalances, or regulatory lacunas or uncertainties – though it selectively recognises market practices that might help to mitigate the effects of these. The Handbook is effectively operated by industry for industry in the space between what is mandated by law/regulation and what is prohibited by law/regulation, excepting aspects that are too self-evident or have garnered insufficient industry consensus. The Handbook is not technically binding (one of the relevant considerations in its past competition law vetting), but operates rather on the basis of recommendations that entitle other syndicate members to express reasonable reproach where recommendations are not followed. This is effective within its limited remit. The Handbook is continuously amended in relation to market developments and is also currently the subject of a root and branch review to make it more reader-friendly in terms of structure and to acknowledge the fading of some now less common market practices.

84 The ICMA Secondary Market Rules and Recommendations essentially constitute OTC cash bond trading terms for use by ICMA member firms and non-member firms alike. They automatically apply to relevant bond trading contracts entered into between ICMA member firms unless agreed otherwise by the parties. To the extent they apply to a contract, the provisions of the ICMA Secondary Market Rules and Recommendations are binding. Such provisions cover notably: terms for the correct settlement of bond trades and what constitutes "good delivery"; how accrued interest on contracts is calculated; "buy-in" and "sell-out" procedures if problems arise in settling transactions; and a standard method of maturity yield calculation based on annual compounding. Actions relating to claims arising from the application of such provisions may be brought in a state court of competent jurisdiction or in a competent court of arbitration (such as eg following unsuccessful ICMA conciliation, an ICMA court of arbitration, on the basis of the dispute resolution mechanism made available by ICMA).

Q34: In the context of MiFID II, which of the FCA Principles for Businesses should apply in relation to MiFID business with Eligible Counterparties?

85 ICMA assumes that FCA Principle 1 ("A firm must conduct its business with integrity") should apply to dealings between "eligible counterparties" (as defined in the UK).

86 The ICMA Secondary Market Rules and Recommendations provide in Rule 1 that "Members are expected to apply the highest standards of professional integrity to all business dealings". Trust within the market is particularly important in cross-border business, where the cost and complexity of disputes, dispute resolution, obtaining and enforcing court rulings can be greater than they are in

a domestic context. While trust is earned and justified by behaviour, *ex ante* statements can help to build trust.

Surveillance and penalties

Q40: What role can more effective surveillance and penalties for wrongdoing play in improving the fairness and effectiveness of FICC markets globally? How can firms and the industry as a whole step up their efforts in this area? And are there areas where regulatory supervision, surveillance or enforcement in FICC markets could be further strengthened?

87 ICMA considers that there should be effective supervision of market participants and that this should reflect a consistent approach to the oversight of market behaviour. In this regard, ICMA is highly supportive of the role of IOSCO as a purveyor of internationally agreed market standards and considers that more should be done to leverage these as the basis for a common set of global market standards.

88 ICMA observes that, as one facet of the response to the financial crisis, the authorities have been seeking to improve standards of behaviour in the financial industry by making the consequences of mistakes very expensive through the imposition of fines. ICMA believes that fines and penalties do play an important role, but that it is equally important to ensure that they do not become disproportionate. Fines and penalties are just one tool in the box and should generally be perceived as the last resort, rather than as a primary weapon, their use evidencing that other avenues have been exhausted and still failed to achieve the desired standards. Furthermore, it is important that fines and penalties should not just fall on firms, but are also appropriately focused on those individual perpetrators whose actions have led to their imposition.

89 ICMA suggests that one way in which regulators could helpfully act to further strengthen fixed income markets would be for regulators to do more publicly to highlight examples of best practice. As a result of their involvement in fixed income markets through their role in regulatory supervision, surveillance and enforcement, regulators have a privileged position from which to be able to identify such examples of best practice.

ICMA
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