Market Update

Asia Securities Forum

November 2016

Brexit and implications for the capital markets

- ICMA continues to work with our members focusing on the implications of the vote on the capital markets, and created a "resource hub" on our website where members can conveniently source relevant Brexit-related papers from ICMA, the authorities and other bodies such as UK and Continental law firms.
- ICMA has completed a thorough review to identify any immediate changes which might be required as a result of the referendum (none at this time) and will keep them under review to ensure they are amended as and when needed in consultation with members.
- There are two abiding themes coming from members with business both in the UK and the rest of the EU:
  - they wish to continue their business with as little disruption as possible; and
  - They would like to minimise the uncertainty so that they are able to plan for the future.

Secondary corporate bond market liquidity

- In July 2016, ICMA published *Remaking the Corporate Bond Markets*, its second study into the state and evolution of the European investment grade corporate bond secondary market.
- The study concludes that, in general, liquidity conditions continue to become constrained, as market participants find it more challenging both to provide and source liquidity.
- Isolating and quantifying contributing factors is difficult at best. However, market participants primarily attribute this deterioration to the confluence of various regulatory initiatives (most notably the increased cost of capital for market makers) and the impact of monetary policy.
- The study also notes that, while overall liquidity continues to decline, most visibly manifested as a lack of immediacy when executing orders, the story is more nuanced.

GDP-linked bonds: a new design for sovereign debt markets

- The basic concept of GDP-linked government bonds is for their coupons and principal payments to be indexed to nominal GDP and in so doing allow both the burden of servicing interest payments and repayment of principal to adjust with the sovereign's ability to pay.
- The major market and social welfare benefit of this is to reduce the risk of sovereign debt crises and disruptive defaults during a recession or downturn. In this regard, often GDP-linked bonds are seen as a form of holding equity in a sovereign, whose entire return will vary with economic performance instead of on a fixed basis.
- In theory, GDP-linked bonds can be designed to reduce the default risk premium by allowing the debt servicing burden to be reduced in times of fiscal duress. On the other hand, for investors, particularly those who believe a particular sovereign may be on its return to prosperity, GDP-linked bonds offer returns that can later outperform corresponding conventional bonds.
- Members of ICMA's Asset Management and Investors Council (AMIC) are right now reviewing and providing comments on this new design and ICMA intends to very soon more widely consult with its members in this regard.

Green Bond Principles

- Voluntary principles for green finance as embodied by the Green Bond Principles (GBP) featured prominently in a new report prepared for the G20 Green Finance Study Group (GFSG) on green bonds, cementing its standing as the overarching guidelines for the green bond market.
- ICMA is an official member of China's Green Finance Committee under the auspices of the People's Bank of China, as well as the Green Finance Study Group under the G20.
- The GBP has developed two disclosure templates – an information template designed for issuers' self-disclosure of GBP alignment, and an external review form. The annual GBP public consultation is scheduled to run in 4Q 2016
- If you are interested in giving feedback to this forthcoming consultation and are not yet a member or observer, please complete the application form on the ICMA website and send it to the GBP Secretariat at greenbonds@icmagroup.org.

Silk Road Bonds

- In 2013, a “Belt and Road” development strategy was announced by the Government in China, the key objective of which is to provide much needed infrastructure along major economic corridors within Asia and extending to the Middle East, Africa and Europe, thereby promoting economic growth and improving living standards.
- Of course, developing infrastructure requires raising significant amounts of finance, which is difficult in countries with less developed financial markets, where connectivity with the international capital market is underdeveloped.
- On 8 September 2016, ICMA and Dagong Global Credit Rating Group (Dagong) jointly hosted a conference at which the concept and challenges of “Silk Road Bonds” were explored.
- Silk Road Bonds are intended to be an internationally recognised asset class, appealing to investors due to highly sought-after yield and diversification benefits, while capable of being scaled to provide the volume of funding required for “Belt and Road” infrastructure

Infrastructure financing in Asia

- The *ASIFMA-ICMA Guide to Infrastructure Financing in Asia* (the Asian Guide), produced jointly by an ASIFMA Infrastructure Working Group together with ICMA, was released in August 2016.
- The Asian Guide is largely based on the European version of the *Guide to Infrastructure Financing*, produced by an AFME/ICMA Infrastructure Working Group in June 2015, but is targeted at the Asian market.
- The Asian Guide is designed to provide practical guidance and information on raising debt finance through banks and the capital markets for funding the immense amount of infrastructure required in Asia, taking account of planning and procurement issues on the transaction process.
- The Asian Guide also highlights how local initiatives from, for instance, the Asian Infrastructure Investment Bank, the International Finance Corporation, the Asian Development Bank and the Credit Guarantee and Investment Facility can help infrastructure projects through funding, credit enhancement and/or guarantees.

Market Abuse Regulation: primary markets

- The roll-out of the EU Market Abuse Regulation (MAR) at the beginning of July has had a tangible effect on how banks and other market participants engage with, and do business in, the capital markets in a number of areas.
- One aspect of MAR which has had a significant impact – perhaps greater than initially anticipated – has been the new rules it imposes in relation to market soundings in the context of securities offerings.
- Under the new rules, for transactions involving issuers with EU listed securities, discussions that banks or issuers have with investors prior to announcement of a transaction which are designed to "gauge the interest" of the investor in the potential transaction will need to be recorded in detail – either literally, through voice recording, or through detailed written notes taken during the interaction.

Leverage Ratio

- In August 2016, the EBA published its report on the impact assessment and calibration of the Leverage Ratio (LR), recommending the introduction of a LR minimum requirement in the EU to mitigate the risk of excessive leverage.
- The EBA's analysis suggests that the potential impact of introducing a LR requirement of 3% on the provision of financing by credit institutions would be relatively moderate, while overall it should lead to more stable credit institutions.
- The LR, which has been introduced in some key jurisdictions (US, Switzerland and UK) and is expected to be introduced more widely from 2018, has come under particular criticism for constraining broker-dealers' balance sheets particularly with respect to low margin business such as SFTs.
- The report notes that, all things being equal, in normal market conditions the LR may make some market liquidity-related activities less attractive for a part of the banking sector and result in increased capital costs for firms with low average risk weights.

ICMA European repo survey

- ICMA's European Repo and Collateral Council has released the results of its 31st semi-annual survey of the European repo market. The survey sets the baseline figure for market size at €5,379 billion, a 4.1% decrease on the December 2015 figure of €5,608 billion and a year on year decrease of 1.6% from the survey in June 2015.
- The decline in the baseline figure since the previous survey largely reflects the reduced number of survey participants. However, a comparison of a constant sample of survey participants shows a small, largely seasonal, rise of 0.5% since December but a year-on-year decline of 1.6%, confirming that the overall trend for repo market activity continues to be downward.
- This long term reduction in repo activity may be attributed to the impact of regulation, including new liquidity and leverage regulations. However, the survey shows that some global systemically important financial institutions (G-SIFIs) have taken the opportunity to increase the size of their repo books. National differences in the implementation of the new rules may have also created opportunities for some banks. If this is the case, then further contraction can be expected in the market.

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