

# ICMA - Market Report

**Asia Securities Forum**

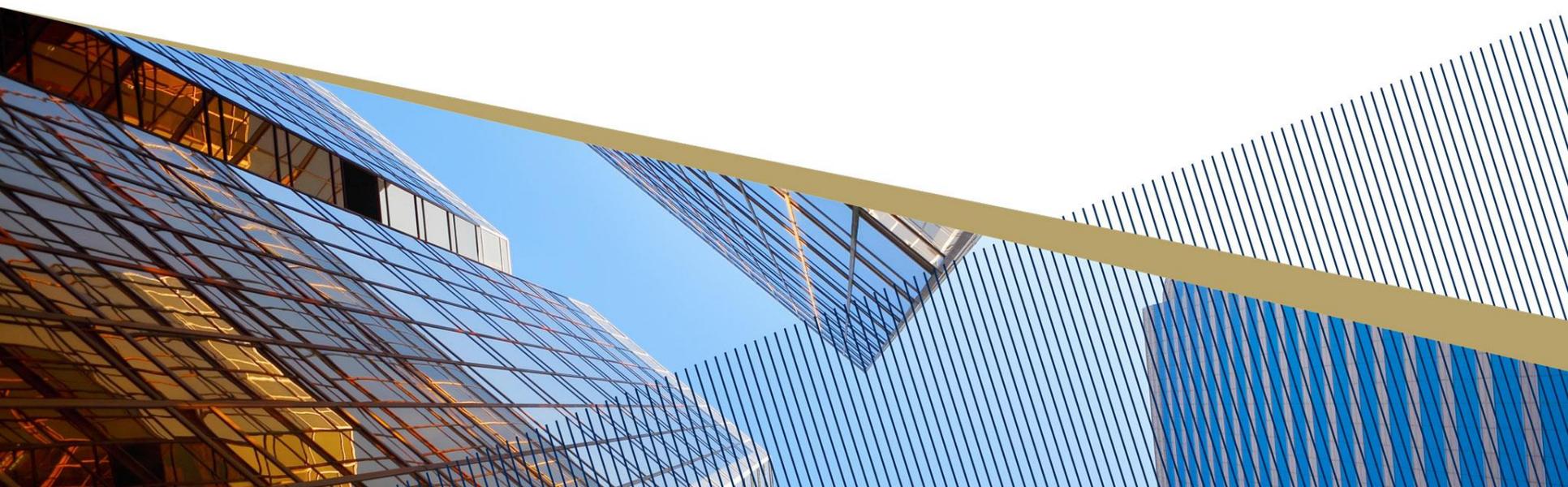
**1 November 2018**

Mushtaq Kapasi





# INTRODUCTION

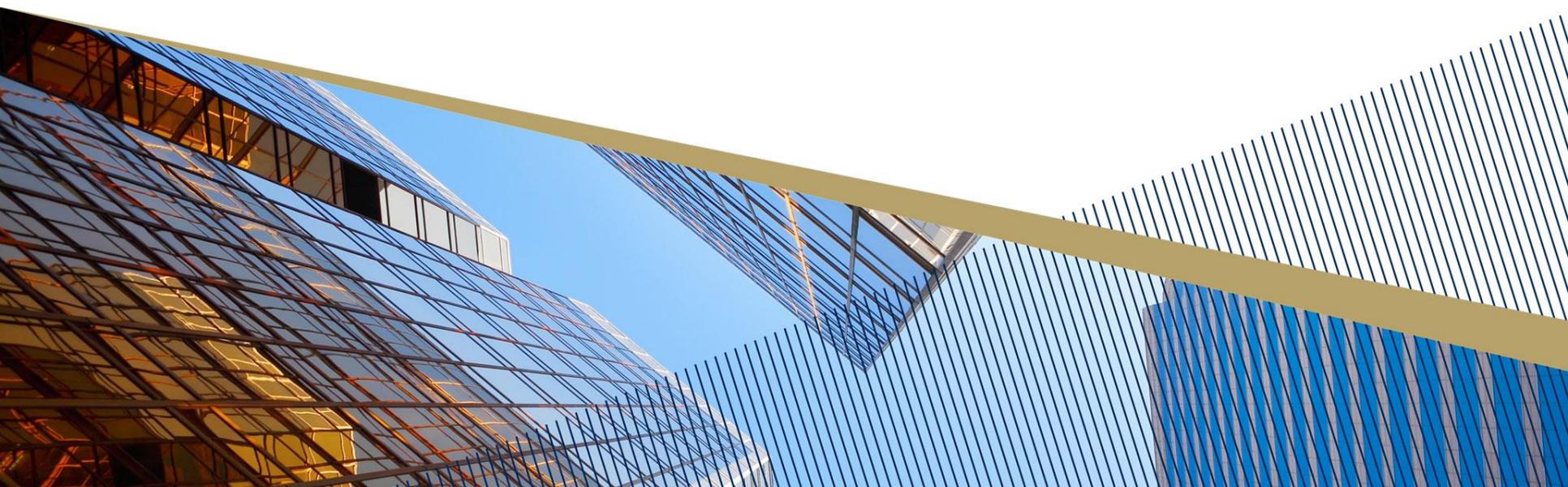


# Overview of ICMA

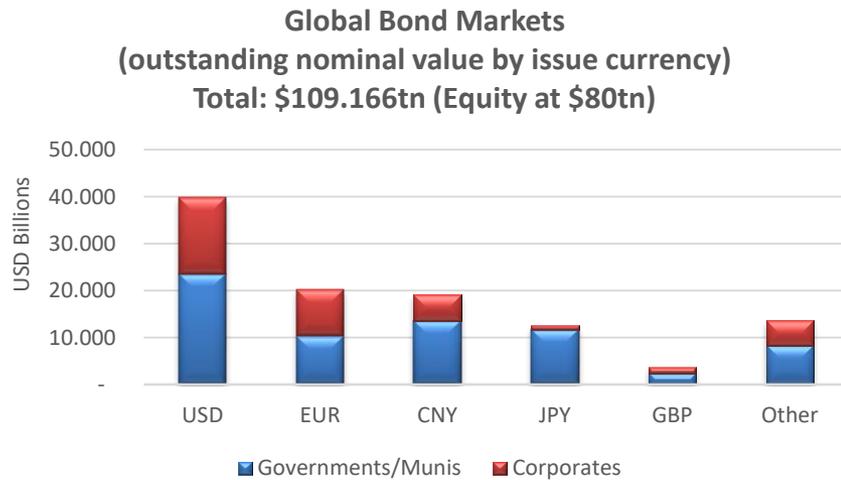
- The International Capital Market Association (ICMA) is a non-profit membership association representing both the buy side and sell side of the industry.
- ICMA's membership includes issuers, intermediaries, investors and capital market infrastructure providers.
- ICMA has more than 530 members located in over 60 countries worldwide.
- ICMA's mission is to promote resilient and well functioning international debt capital markets.
- The four main pillars of ICMA's work are:
  - Primary bond markets
  - Secondary bond markets
  - Repo and collateral
  - Green, social, and sustainable finance
- ICMA works with its members to create market best practice and documentation:
  - Primary Dealers Handbook
  - Secondary Market Rules and Recommendations
  - Guide to Best Practice in the Repo Market
  - Global Master Repurchase Agreement (GMRA)

[www.icmagroup.org](http://www.icmagroup.org)

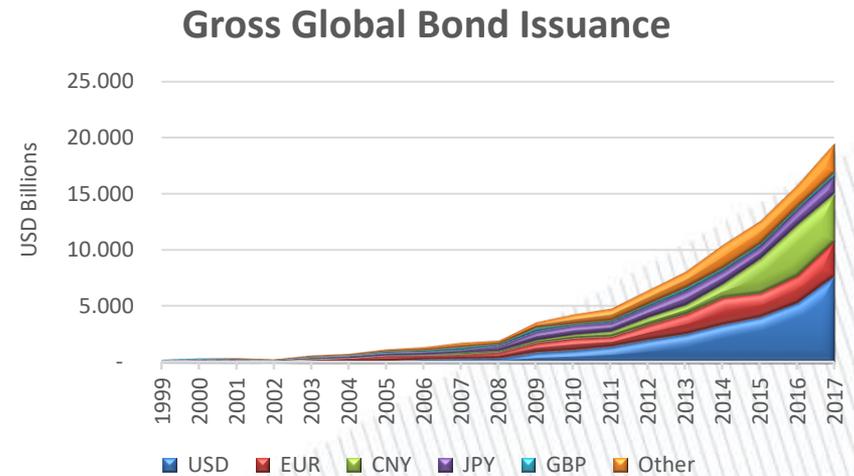
# ASIA CROSS-BORDER CORPORATE BOND MARKET



# Global bond market snapshot

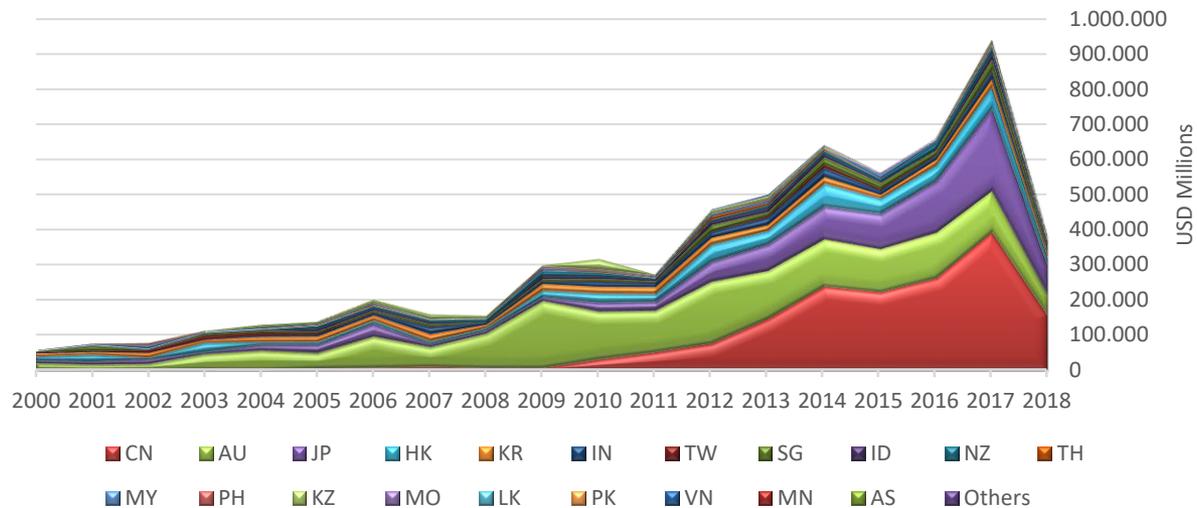


Source: ICMA analysis using Bloomberg data



# Rapid rise in Asian issuance

APAC G3 Corporate Issuance by Country  
2017: US\$940bn

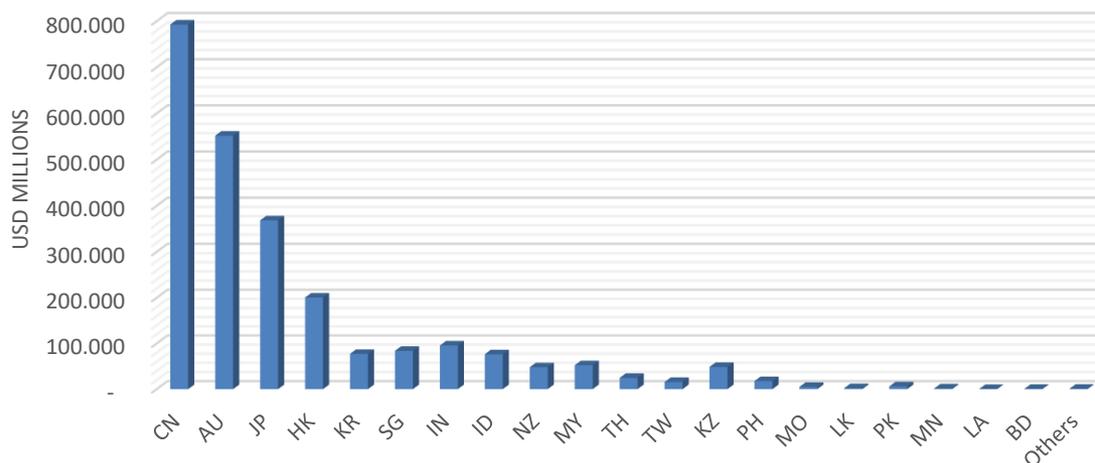


Source: ICMA analysis using Bloomberg data

- » Rapid rise in issuance and the size of the G3 (in particular US\$) corporate bond market since around 2010-11
  - Accelerated further in the past two years, driven primarily by Chinese financial and non-financial issuers coming to the market.
  - 2011-17: annual G3 APAC corporate issuance has more than trebled to about US\$940bn
  - China accounts for > 40% of total issuance in 2017, compared with < 20% in 2011.

# Market becoming more regional

Outstanding APAC G3 Corporate Issuance by Country of Risk  
[Total: US\$2.468tn]

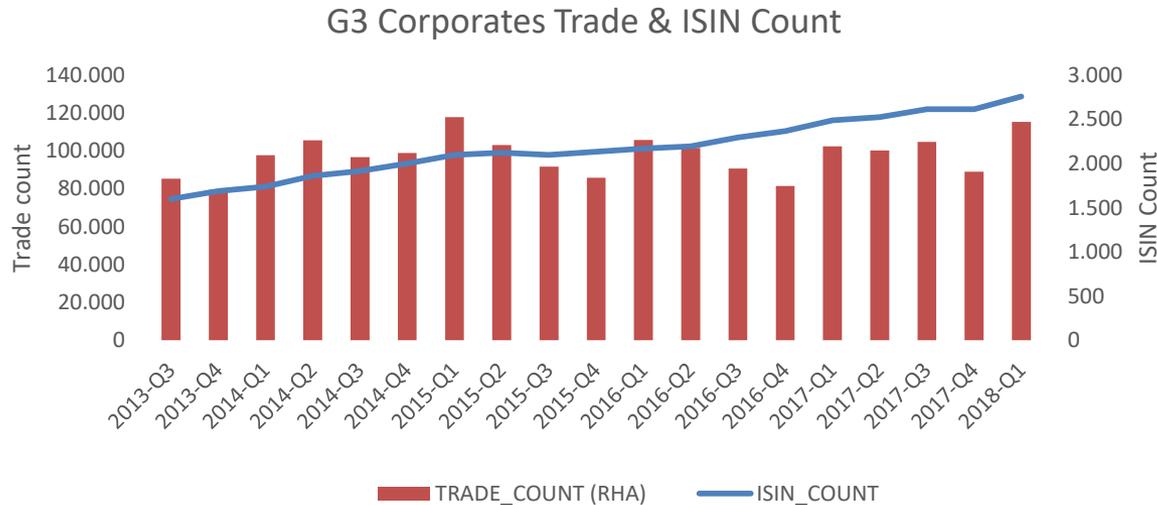


Source: ICMA analysis using Bloomberg data

## » 'Asia-fication' of the APAC markets

- Regional investment funds / life insurers taking an increasing share of buy-side flows in G3 credit.
- Chinese investment firms and securities companies opening offshore offices (primarily in Hong Kong).
- Internationalization of LCY (particularly CNY) markets in the APAC region

# APAC corporate bond liquidity



Source: ICMA analysis using Trax data

## » Secondary market liquidity: a mixed picture

- Liquidity for IG G3 corporates tends to be relatively good, although this is very much a function of the underlying issue size.
- However, while bid-side liquidity is generally good, offer-side liquidity is much thinner, particularly for large-size trades.
- Relative to the increase in overall G3 corporate issuance and outstanding bonds, secondary market trading volumes have lagged.

# Asia corporate bond market - trends

- » Repo and securities lending markets for APAC G3 credit are underdeveloped.
  - Limits secondary market growth and activity.
  - Many regional investors do not lend their holdings back into the market
  - Supply is largely contingent on hedge funds and international real money investors
- » Corporate single name CDS markets are not large
  - Either as a hedging instrument or an alternative investment vehicle
  - Diminution of hedge fund involvement in the regional market

# Asia corporate bond market - trends

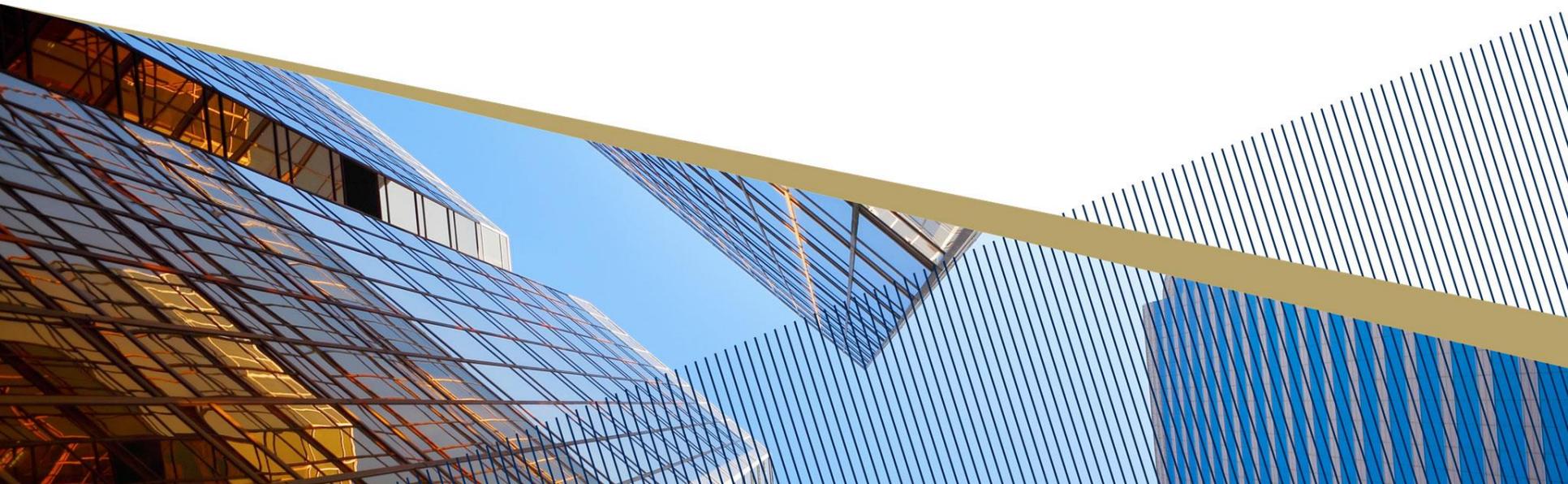
## » Regulatory impacts

- Mostly imported from US and European regulation
- Basel III has put pressure on the balance sheets and trading books of international banks, as has the Volcker Rule
- MiFID II/R is being 'globalized' by a number of European and international investment firms.
- Regional regulators appear to be watching the impacts of MiFID with a view to introducing their own regulatory initiatives around transparency and best execution.

## » Financial technological innovation

- Asia leads in some areas of fintech
- However, relatively slow uptake of trading platforms in the cross-border bond markets.
- Major global incumbent platforms also tend to lead in the APAC markets, with a handful of international and regional platforms carving out geographical and product niches
- Overall levels of e-trading seem to be low compared to the US and Europe.

## BREXIT AND RISKS TO THE CAPITAL MARKET



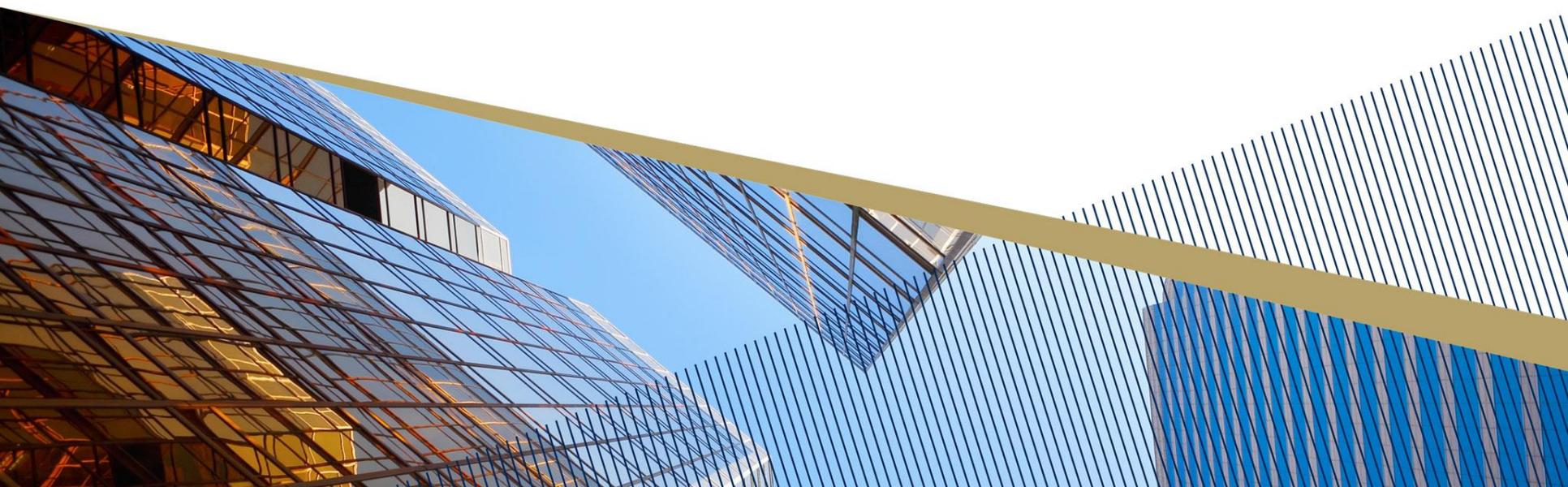
# Brexit and “Cliff-Edge” Risks

- » In the international capital markets, cliff-edge risks will arise when passporting rights between the UK and the EU27 cease.
- » Cliff-edge risks will arise most immediately if the UK leaves the EU without an agreement on Brexit on 29 March 2019, assuming that the UK does not suspend its decision to trigger Article 50 of the EU Treaty, and that the deadline is not extended.
- » If there is an EU27/UK withdrawal agreement, as a result of which passporting rights continue during a transition period after Brexit, cliff-edge risks will still arise if there is no EU27/UK trade agreement at the end of the transition period at the end of 2020, unless the transition period is extended.
- » And, even if there is an EU27/UK trade agreement, there will be cliff-edge risks if the agreement does not preserve existing passporting rights.

# Brexit and “Cliff-Edge” Risks

- » It appears that, on Brexit, firms will be able to carry out contractual obligations already agreed between UK and EU27 entities on cross-border financial contracts.
  
- » The most important cliff-edge risks include:
  - When passporting ceases, market firms may no longer be able fully to service some outstanding contracts across EU27/UK borders;
  - Central counterparties may no longer be recognised across borders;
  - Barriers to the cross-border flow of personal data may disrupt the provision of financial services;
  - Delegation of fund management across borders, which is a global practice, may be restricted.
  
- » If it is not possible to rely solely on regulatory equivalence, the other option for capital market firms is to ensure that, before passporting rights cease, they are authorised to provide financial services in both the EU27 and in the UK.

## BENCHMARK REFORM AND LIBOR



# The problem with LIBOR

- » The Chief Executive of the UK Financial Conduct Authority (FCA) has said that the FCA would no longer intend to use its powers to persuade or compel banks to submit contributions for LIBOR after the end of 2021

“LIBOR is meant to measure the short-term unsecured funding costs of banks. But the reality is that, since the financial crisis, LIBOR really has become the rate at which banks do not lend to each other. Bank funding markets have changed enormously.”

– Bank of England

“Inherent fragility of its ‘inverted pyramid’, where the pricing of hundreds of trillions of dollars of financial instruments rests on the expert judgment of relatively few individuals, informed by a very small base of unsecured interbank transactions”

– US Federal Reserve

“The globally most relevant interbank interest rates benchmarks, like LIBOR and EURIBOR, were unregulated and their methodologies and governance allowed manipulation on a scale rarely seen in the financial sector.”

– ESMA

# Adoption of risk-free rates - options

1

Replace term LIBOR in new bond market transactions with a forward-looking term rate derived from the relevant preferred risk-free rate

2

Replace term LIBOR with the relevant preferred risk-free rate, compounded overnight in arrears (because the preferred risk-free rates are backward-looking overnight rates)

3

Market to be offered a choice between forward-looking and backward-looking rates

# Conversion of legacy bonds

- » Conversion of legacy bonds would be more complex than converting derivatives
- » Unlike the derivatives market, which uses protocols to amend large volumes of contracts, protocols are not – and may not be able to be – used in the bond market
- » Amending the terms of bond issues requires bondholder consent
- » The threshold for bondholder consent is generally set at a high level, so it would be very difficult, time-consuming and expensive to obtain bondholder consent to make the changes that would be necessary for conversion
- » The outcome could not be guaranteed, without legislative intervention, which would need to be coordinated across different jurisdictions internationally
- » Longer-dated bond market issues, which are due to mature after the date when LIBOR may no longer be available, may fall back to a fixed rate absent intervention
- » A credit adjustment spread may need to be applied as a result of the replacement of LIBOR (which includes bank credit risk) by risk-free rates (which do not)

## GREEN, SOCIAL, AND SUSTAINABILITY BONDS



# Green, Social and Sustainability Bonds

| Bond Type                  | Use of Proceeds  |
|----------------------------|--|
| <b>Green Bond</b>          | Finance <b>projects with a clear environmental benefits</b> (e.g. renewable energy, energy efficiency, climate change adaptation)  |
| <b>Social Bond</b>         | Finance <b>projects that address social issues</b> and/or seek to achieve positive social outcomes especially for a target population (e.g. poor, vulnerable, unemployed, uneducated etc.) |
| <b>Sustainability Bond</b> | Finance a <b>mix of green and social</b> projects  |

## The Green Bond Principles

### Pillar 1

Use of proceeds –  
Identifying eligible  
projects

### Pillar 2

Process for project  
evaluation and  
selection

### Pillar 3

Management of  
Proceeds:  
Ring-fencing  
or notional  
equivalence

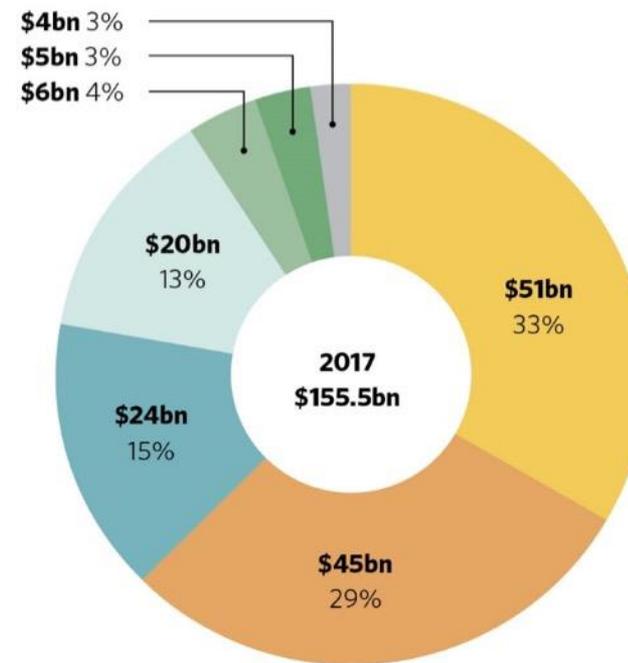
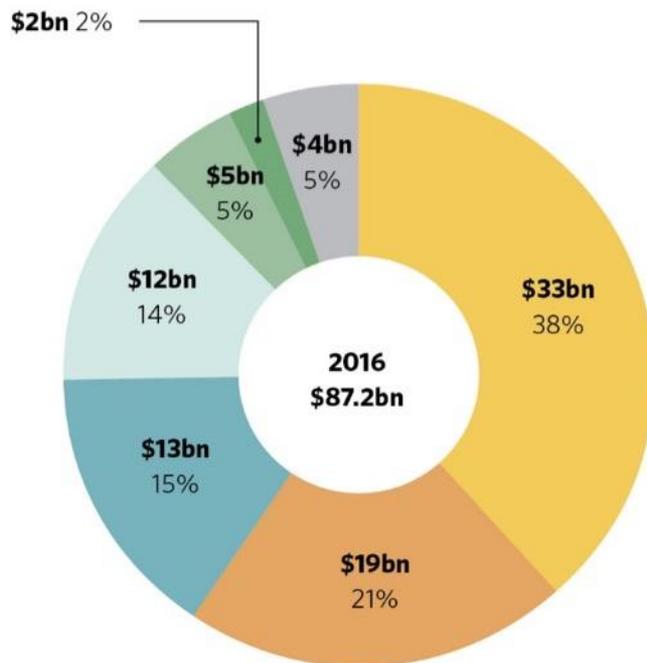
### Pillar 4

Reporting:  
use of proceeds,  
impact etc.

External review recommendation

# Green Bonds – use of proceeds

## Green Bonds fund a variety of environmental projects

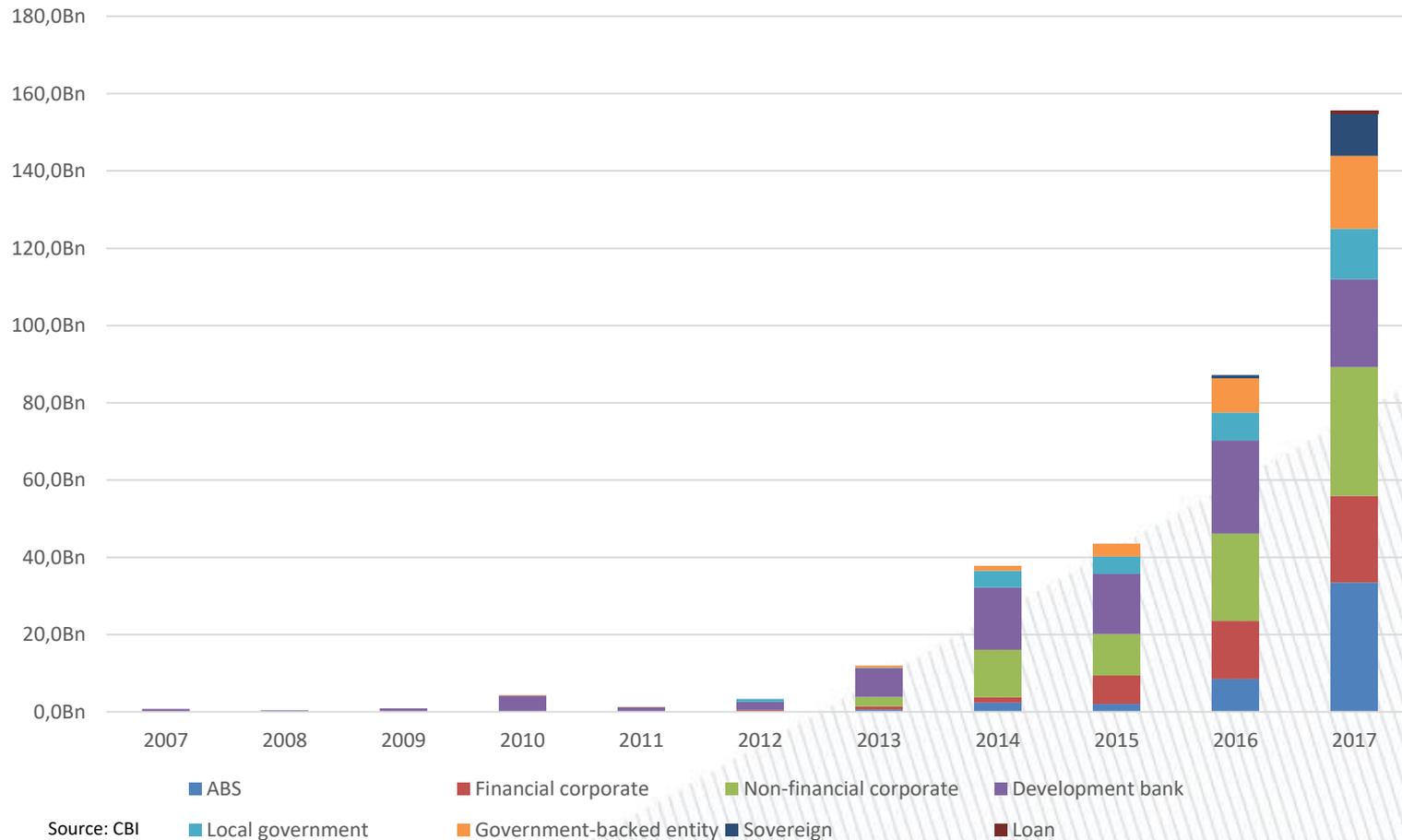


Source: BFI

December 2017

# Green, Social and Sustainability Bonds

Annual Issuance – by Issuer Type





# Thank you

## Contact details:

» Mushtaq Kapasi (+852 2531 6590 / [mushtaq.kapasi@icmagroup.org](mailto:mushtaq.kapasi@icmagroup.org))





This presentation is provided for information purposes only and should not be relied upon as legal, financial, or other professional advice. While the information contained herein is taken from sources believed to be reliable, ICMA does not represent or warrant that it is accurate or complete and neither ICMA nor its employees shall have any liability arising from or relating to the use of this publication or its contents.

© International Capital Market Association (ICMA), Zurich, 2018. All rights reserved. No part of this publication may be reproduced or transmitted in any form or by any means without permission from ICMA.