From the Desk of Ian Russell
President and CEO, Investment Industry Association of Canada (IIAC)

IIAC Fixed Income Market Regulatory Update – April 28, 2016

Canada

CSA Outlines Next Steps for Regulatory Reform of the Fixed Income Market

- On April 21, 2016, the Canadian Securities Administrators (CSA) outlined next steps in implementing a plan for regulatory reform of the fixed income market.
- The CSA is working with the Investment Industry Regulatory Organization of Canada (IIROC) to increase transparency in the corporate debt market. IIROC will become the designated Information Processor for corporate debt securities in Canada.
- Currently, under National Instrument 21-101 (Part 8), marketplaces, inter-dealer bond brokers and dealers are required to provide prompt and accurate order and trade information for corporate debt securities to the Information Processor, as required by the Information Processor.
- Over the longer term, the CSA and IIROC will review fixed income trading activity, as well as the appropriateness of the initial dissemination delay (i.e. two days after a trade is executed, or T+2), subject to volume caps, to determine whether they continue to be appropriate or need to be changed. Any changes will be subject to public consultation.
- The CSA and IIROC will have to determine how the existing CanPX transparency system will evolve in response to the reforms to address any possible transparency gaps in the corporate debt market.
- The CSA and IIROC are currently reviewing dealers' practices regarding new issue distribution and will determine what, if any, regulatory action is needed in this area, in light of concerns that some market participants have been unable to participate in new debt offerings. They intend to seek input from buy-side participants to understand their perspective and experience.
- The CSA news release is available here. The CSA Notice describing in greater detail the next steps in implementing a plan for regulatory reform of the fixed income market is available here. Appendix A includes a summary of comments received from stakeholders, including the IIAC, and CSA responses.

Europe

Clearing Houses Asked for Brexit Plans

- The Bank of England has requested London's clearing houses to draw up contingency plans on how they would respond to increased transaction flow and stepped up volatility in the event of a UK exit from the European Union, and on possible adjustments to clearing services. Read more here.
- Also of interest is an article in *The Telegraph* that answers the question: What will Brexit mean for the City of London?
- A Bloomberg article alludes to the possibility of more than 70 billion euros of corporate bond underwriting migrating from London to Paris in the event of a Brexit.

Call for Evidence on EU Regulatory Framework for Financial Services

- In September 2015, Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union, requested feedback (i.e. *Call for Evidence*) on the EU rule-making process since the 2008 financial crisis. The deadline for comment was January 31, 2016. The financial industry responded overwhelmingly that regulations had gone too far in achieving financial stability at the expense of an expanded regulatory burden and increased market inefficiency.
- With respect to the impacts on market liquidity, the evidence varied. The tendency of responses was to focus on individual regulatory initiatives (i.e. Leverage Ratio, the Net Stable Funding Ratio, bank structural reforms). Few attempted to assess the holistic impact of regulation. Granted, it is difficult to disentangle regulatory impacts on markets from macro-economic or monetary impacts.
- Leverage Ratio featured in more responses than any other regulation, as it has a cross-cutting impact. The European Commission concluded it needs to spend a lot of time considering and recalibrating the Ratio, where necessary.
- The European Commission will be hosting a Public Hearing on the *Call for Evidence* in Brussels on May 17, 2016. This is a further opportunity for stakeholders to substantiate their respective submissions and discuss the initial outcomes from the consultation.
- IIAC President and CEO Ian Russell will attend the hearing in his capacity as Chair of the International Council of Securities Associations (ICSA) to hear the Commission's summary of the submissions and offer comment. The hearing will give an indication about how technical policy and legislation might be implemented. Attending with Mr. Russell will be Peter Eisenhardt, Secretary General, ICSA.
- The European Commission is expected to publish a summary report on the *Call for Evidence* in July 2016.

EU Bond Market Liquidity Review

- The European Commission will conduct a comprehensive review of eroding liquidity in corporate bond markets. The Commission Services published a tender on March 18, 2016 for a study on the drivers of corporate bond market liquidity. The deadline for receipt of tenders is April 29, 2016.
- The Commission Services will also establish an expert task force in 2017 with the mandate to bring forward recommendations to strengthen market liquidity.
- In a speech on April 21, 2016, Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union, said: "The decline of market liquidity is, of course, the subject of a lively debate." He added, "when it comes to new measures, we'll be careful to avoid anything that could make the situation more difficult."
- Commissioner Hill has written to the European Securities and Markets Authority (ESMA) to request a "more cautious approach" on liquidity calibrations related to MiFID II pre- and post-trade transparency.
- You can read Jonathan Hill's speech here.

European Commission Considering Next Steps in Putting in Place a Framework for Covered Bonds

- The European Commission consultation on an EU-wide framework for covered bonds and similar structures for SME loans has been completed. Seventy-two submissions were received.
- A number of respondents consider the price divergence observed during the financial crisis as an indication of fragmentation in the EU covered bond markets. Others argue that the observed fragmentation reflects the intrinsic risks of the different underlying assets depending on their quality and location, and not the absence of a common regulatory framework.

- Many respondents mentioned that a more integrated market for covered bonds could deliver a number of benefits in terms of better comparability between Member States and, as a result, deeper, more liquid and more robust national markets.
- Jonathan Hill, European Commissioner for Financial Stability, Financial Services and Capital Markets Union, said: "My aim is not for covered bond prices to be the same across Europe or to have one harmonised framework. … My goal is to see whether the experience, expertise and best practice that countries like Germany, Denmark or France have built up over the years, can be used to create a more integrated market. In particular, I want to look at whether there are unnecessary legal barriers or differences that stand in the way of investment in covered bonds across Europe."
- The Commission's *Capital Markets Union: First Status Report* is available here.
- Jonathan Hill gave a speech on the topic of covered bonds. It is available here.

United States

U.S. Federal Reserve Issues Final Rule on Banks' Municipal Bond Holdings

- One of the key reforms of Basel III, the Liquidity Coverage Ratio (LCR), requires banks to hold an adequate amount of unencumbered High Quality Liquid Assets (HQLA) that can be converted easily and immediately into cash in private markets to meet banks' liquidity needs for a 30 calendar day liquidity stress scenario.
- U.S. municipal bonds were excluded from the definition of HQLA in the final LCR, while certain foreign sovereign bonds were included. There has been a push in the U.S. to classify U.S. municipal bonds as HQLA.
- On April 1, 2016, the U.S. Federal Reserve permitted banks to count investment-grade and municipal bonds, including certain small issuances, as HQLAs, up to a certain level if the securities meet the same criteria as corporate bonds. Insured bonds can also qualify as long as they meet criteria that apply to municipal bonds without insurance.
- According to the Securities Industry and Financial Markets Association (SIFMA), banks hold about 14% of all municipal debt outstanding.
- The final rule applies only to institutions supervised by the Federal Reserve, i.e. bank holding companies, certain savings and loan holding companies, and state member banks.
- The two other bank regulators—the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corp. (FDIC)—still do not allow the institutions they regulate to count municipal bonds toward their liquidity buffers. The OCC regulates and supervises national banks and federal savings associations as well as federal branches and agencies of foreign banks, while the FDIC is the primary federal supervisor for state-chartered banks and savings institutions that are not members of the Federal Reserve System.
- Additional details are available here.

The Investment Industry Association of Canada (IIAC)
Representing Canada's Investment Dealer Firms

The Investment Industry Association of Canada (IIAC) is the national association representing the position of 144 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. The IIAC has successfully argued for positive change in securities regulation and public policy that has improved market efficiency and lowered costs for dealers and market participants without jeopardizing investor protection. Click here to read the Highlights of Our 2015 Achievements.

The IIAC's efforts have assisted Member firms address:

- CRM rule-making and managing industry CRM compliance efforts
- Cyber threats
- Tax reporting requirements (e.g. FATCA, OECD Common Reporting Standard, and Specified Foreign Property Tax Reporting)

The IIAC has also taken a leading role among trade associations in laying out the rationale for a cooperative securities regulator, pension reform and OTC derivatives reform with positive results.

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