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INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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

IIAC Fixed Income Market Regulatory Update

Domestic and Foreign Regulatory Developments and Implications for Canadian Markets

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Canada

Canadian Securities Regulators Seek Comment in Advance of Move to T+2 Settlement Cycle

- In recent years, the global financial industry has increased efforts to mitigate operational and systemic risk in capital markets. One way to do so is to settle trades more quickly. This not only reduces market exposure from post-trade interest rate movements, but means lower capital and liquidity requirements.
- Canada has committed to shortening the securities settlement cycle from the current three days (T+3) to two days (T+2) by September 5, 2017, the same day U.S. markets plan to move to a T+2 settlement cycle.
- Both the Investment Industry Regulatory Organization of Canada (IIROC) and the Canadian Securities Administrators (CSA) issued separate consultation papers seeking input on proposed amendments as part of the plan to shorten the standard settlement cycle for trades.
- The IIROC paper is available here; the CSA paper is available here. Comments to IIROC are due by October 26, 2016. Comments to the CSA are due by November 16, 2016.
- The IIAC is forming an industry working group to review the proposed amendments and consultation papers. The industry is expected to consider operational improvements to manage settlement risk in the move to T+2. Comments are also sought on the adequacy of the current settlement discipline regime and whether enhancements to the regime might be desirable to help support a smooth transition to T+2.

CBIA Letter: Issues Disrupting the Investment Activities of Canadian Institutional Bond Investors

- In a letter, the Canadian Bond Investors' Association (CBIA)—which represents 48 of the largest fixed income institutional investor organizations in Canada—has alerted Canadian regulators to two problems arising from recent regulatory action.
- First, the Canadian Securities Administrators (CSA) decision under National Instrument 31-103 prevented foreign dealers from concurrently holding registration as International Dealer and Exempt Market Dealer (EMD).
- Most foreign dealers opted to relinquish their EMD registration. This meant that foreign dealers under the International Dealer registration are no longer permitted to engage in

secondary market trading activities in foreign bonds for Canadian investors, including Canadian bonds that were initially offered primarily outside Canada by foreign dealers. This restriction limits Canadian buy-side firms access to U.S. debt securities.

- Second, in June 2016, under National Instrument 45-106, the CSA restricted International Dealer registrants from distributing primary offerings, or new issues, of U.S. and other global securities to Canadian investors.
- The Canadian buy-side argued this provision severely restricts access to U.S. credits, and places these firms at a competitive disadvantage to the Canadian affiliates of U.S. buy-side firms.
- In a Financial Post article, IIAC President and CEO Ian Russell stated the regulatory changes were aimed at strengthening investor protection by further clarifying regulators' expectations when it comes to dealing with Canadian investors. If some of those changes are causing disruption in the market, whether it be through issuer access to capital or investor access to product, then the CSA should undertake some additional work to determine whether further modifications to the regulations are in the public interest.

Europe

IOSCO Seeks Public Comment on its Analysis of Liquidity in Corporate Bond Markets

- The Board of the International Organization of Securities Commissions (IOSCO) published Consultation Report on liquidity of the secondary corporate bond markets. The study looked at the 2004-2015 period.
- IOSCO did not find substantial evidence of a deterioration in secondary corporate bond markets liquidity relative to historic norms for non-crisis periods. This work was based on the quantitative analysis of conventional liquidity measures. However, the majority of both buy-side and sell-side respondents to the IOSCO survey perceive market liquidity to have decreased.
- IOSCO also noted there is no reliable evidence that high capital requirements from regulatory reforms, and related increase in cost of capital, has reduced bond inventories. Regulators continue to monitor closely the impact of regulatory reforms.
- Other factors may be impacting secondary corporate bond market liquidity, including cyclical factors, the market for credit default swaps and the repo market.
- The IOSCO conclusion that corporate bond liquidity has not deteriorated significantly, contradicts the position of the investment industry and most corporate issuers.
- The study did reveal meaningful changes to the characteristics and structure of secondary corporate bond markets—changing dealer inventory levels, increased use of technology and electronic trading venues, and changes in the role of participants and execution models (i.e. dealers shifting from a principal model to an agency model).
- IOSCO plans to examine in detail the transparency regimes and regulatory requirements in place in various jurisdictions. IOSCO expects to discuss in more detail the relationship between transparency and liquidity, and the decisions regulators have taken to address it (volume caps, delayed dissemination, etc.).
- IOSCO encourages the public to comment on the analysis, data and conclusions in its consultation report. Comments on the report can be submitted up to September 30, 2016.

- The conclusion among regulators that eroding bond liquidity is not a pressing concern has opened up a worrisome chasm in positions on bond liquidity between the regulators and market practitioners. This means remedial action is unlikely to be forthcoming in the foreseeable future. Market participants are, therefore, adjusting their business models to accommodate the new reality. Sell-side firms are acting more on an agency basis than as market-makers, or are severely restricting market-making to limit exposure. The buy-side is taking initiatives to locate and create liquidity in bond markets.
- The consultation paper is available here.

The Fair and Effective Market Review (FEMR) Implementation Report

- On 28 July 2016, the Chairs of the Fair and Effective Markets Review (FEMR) published a full implementation report to the Chancellor of the Exchequer, the Governor of the Bank of England and the Chairman of the Financial Conduct Authority. Among the key recommendations was the decision to establish the Fixed Income, Currency and Commodities (FICC) Market Standards Board (FMSB).
- At the end of June 2016 the FMSB wrote to the HM Treasury, the Bank of England and the Financial Conduct Authority (FCA) with an update, and released its first market standard on Reference Price Transactions for public comment.
- The Report announced several near-term actions to improve conduct in FICC markets.
    - The Review recommended the FCA and the Prudential Regulatory Authority (PRA) should consult on developing a mandatory form to assist firms prevent the 'recycling of individuals with poor conduct records between firms.
    - The FMSB was encouraged to provide guidance on expected minimum standards of training and qualifications for FICC market personnel.
    - The Review recommended a set of common standards for trading practices in FICC markets written in readily understood language.
    - The Review recommended a set of common standards developed and promulgated globally. The International Organization of Securities Commissions (IOSCO) has established a Task Force on Market Conduct.
    - The Review recommended widening the scope of criminal sanctions for market abuse. It also recommended the maximum sentence for criminal market abuse be lengthened from seven to ten years.
    - The Review established a FICC Market Standards Board (FMSB) to identify where market standards could be strengthened; where guidelines would be helpful; and to promote adherence to standards and international convergence to standards.
    - The FMSB has attracted 36 firms as members, including asset managers; investment banks; institutions; market infrastructure providers, such as stock exchanges; custodians; and corporates to provide the quality, clarity and market-wide understanding of FICC trading practices. There are six Standing Sub-Committees examining different aspects of the marketplace: Fixed Income Rate Products, Fixed Income Spread Products, Currencies, Commodities, Conduct and Ethics, and Codes and Standards Convergence (reviewing existing policies and standards in place in the markets to avoid duplication).
    - The Sub-Committees operate within an independent organization, the FICC Markets Standards Board Limited, a UK company limited by guarantee. The Permanent Chair

is Mark Yallop who succeeded Interim Chair Elizabeth Corley on July 25, 2016. Previously, Mark Yallop was UK CEO for UBS Private Wealth.

- The Fixed Income Rates Product Sub-Committee selected Reference Price Transactions (RPT) as its first market standard. In an RPT, all transactional information (buyer, seller, notional, settlement date, etc.), except the execution price, are agreed and specified at the time of the transactions. The execution price is based on agreed-upon spread from the reference price (may be the reference price). The reference price could be independently sourced price (Trade Web, or ICE Swap Rate), average bid price in particular government bond auction, or closing levels for a dealer administered index.
- The nature of the RPT is that the client eliminates uncertainty over the difference between the reference price and the execution price.
- The Core Principles of RPTs:
  - Possible conflicts of interest should be managed by dealers to promote fair treatment of clients
  - Dealer should ensure client is aware of the key mechanics of RPTs, in particular that hedging can take place before, during or after the reference time
  - Dealer should ensure that hedging is solely aimed at risk mitigation and never performed to influence or manipulate the reference price
  - When hedging takes place at a portfolio level, the dealer should ensure management of their aggregate positions is consistent with this standard
  - Clients should not execute RPTs to influence the reference price and should not attempt to influence the reference price during the hedging window
  - Information about an RPT should not be shared externally
  - Dealer should implement processes and record-keeping to monitor RPTs to ensure compliance with this standard
  - Firms should ensure personnel have been trained on the substance of this standard
- The Commodities Sub-Committee has published standards on the use of 'Binary Options in Commodities Markets', particularly the management of conflicts of interest.
- The Conduct and Ethics Sub-Committee is creating a framework to adhere to FMSB standards, namely members required to comply on a global basis with FMSB standards and explain circumstances where unable to comply.
- The Codes and Standards Convergence Sub-Committee has undertaken significant outreach to international authorities and relevant standard setters.
- Industry bodies other than the FMSB have undertaken work to develop a Global FX Code, a Securities Lending Repo and Money Markets Code and a Precious Metals Code.
- The regulatory framework for Libor should be extended to cover seven additional major UK-based FICC benchmarks.
- The Review recommended a new statutory civil and criminal market abuse regime for spot FX.
- The Review recommended market conduct be monitored with all standards under the Senior Managers and Certification Regimes.
- The Review recommended steps to improve firm and trader awareness of the application of competition law to activities in FICC markets.

    - The Review concluded it would be beneficial if international authorities collaborated to raise standards in global FICC markets.
- At this stage, the FMSB recommendations are unlikely to interfere with cross-border trade in debt and derivative securities. The MiFID II proposals, however, will undoubtedly have more serious implications for UK and EU debt trading operations, and for cross-border flows.

Asia

Report of the Working Group on Development of Corporate Bond Market in India

- The Financial Stability and Development Council Sub-committee (FSDC-SC), constituted by the Government of India, created a Working Group on Corporate Bonds. The Group included representatives from the Ministry of Finance, Reserve Bank of India, the Securities and Exchange Board of India (SEBI), the Insurance Regulatory Development Authority of India (IRDAI) and the Pension Fund Regulatory and Development Authority (PFRDA).
- The Working Group made a number of recommendations to guide the development of India's corporate debt market.
- Among the Group's recommendations:
    - Standardisation of corporate bond issuance. At present, the secondary market yield of corporate bonds reported on the reporting platforms of the stock exchanges do not follow uniform standard as the market follows different conventions and divergent practices for holiday conventions, day count convention and basis for yield calculation.
    - Relaxing norms for allowing foreign investments. The Working Group suggested amendments in regulations to allow foreign portfolio investors (FPIs) to invest in unlisted debt securities and pass-through securities issued by securitisations SPVs.
    - Creation of a bond index. Designing debt indices has been challenging in India as the market lacks breadth and depth. SEBI is in dialogue with stock exchanges to design a suitable debt market index.
    - Encouraging corporates to tap the market beyond a cut-off level. Large corporates with borrowings from the banking system above a cut-off level may be required to tap the market for a portion of their working capital and term loan needs.
- A centralised database for corporate bonds markets may be established expeditiously in two phases, for secondary market trades by the end of August 2016 and for both primary and secondary markets by the end of October 2016.
- The Working Group also said regulated entities (like banks) may be encouraged by the regulators to act as market makers in corporate bond market subject to appropriate risk management framework.
- You can access the full paper and recommendations by clicking 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 133 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.

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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