

*From the Desk of Ian Russell  
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## IIAC Fixed Income Market Regulatory Update – December 9, 2015

### Canada

#### Bank of Canada Canadian Fixed-Income Forum (CFIF)

- **The Bank of Canada has established a new senior level industry-wide forum to discuss market practices, developments in the structure and functioning of fixed income markets, and related policy issues.**
- The goal of the CFIF is to enhance the efficiency and resilience of the Canadian fixed-income market.
- [Canadian Fixed-Income Forum members](#) represent a broad regional mix of fifteen small and large institutions active in the Canadian fixed-income market, across both the buy and sell side.
- Information on CFIF's activities, including its objectives and organization, membership, meeting dates, agendas and summaries, is available on the [Canadian Fixed-Income Forum webpage](#).
  - In its inaugural meeting on October 7, 2015, the CFIF focused primarily on issues of market liquidity, noting that **most Canadian fixed-income instruments have experienced a reduction in liquidity** over the past two years, particularly corporate bonds.
  - The most significant drivers of declining liquidity were regulation and reduced dealer market-making capacity.
  - It was noted **there has been a move away from principal-based trading toward agency-based trading**, largely driven by changes in the regulatory framework.
  - Some members believed the liquidity in Government of Canada bonds was at its lowest level since the crisis.
  - **The buy-side described having to adjust their trading strategies**—more macro-based rather than tactical.
  - **The sell-side noted an increase focus on balance-sheet efficiency** as a result of regulatory changes. Regulations were reducing systemic risk, but also redistributing risk from traditional market-makers to investors.
  - Most members were "very concerned" about liquidity under conditions of market stress.
  - The group's next meeting will be held in January 2016.

#### Transparency in Debt Markets

- The release of the Canadian Securities Administrators' (CSAs) [proposal](#) to enhance transparency in the fixed income market, and request for comment, sets the stage for a debate on effective transparency of domestic debt markets.
- The latest IIAC [Letter from the President](#) commends the CSA for ongoing consultations on transparency and argues **the optimal approach should embrace the best attributes of the existing CanPx transparency system and the new IIROC Market Trade Reporting System (MTRS 2.0)** which was introduced on November 1, 2015.

## Legal Entity Identifier (LEI) System

- The global LEI is a 20-character reference code that uniquely identifies entities that engage in financial transactions. It is designed to assist regulators track financial transactions in the global marketplace so they can identify and manage financial risks. It was established for a wide range of potential uses: assess systemic risk, conduct market surveillance and enforcement, supervise market participants and conduct resolution activities. The initiative is endorsed by the G20 Finance Ministers and Central Bank Governors and is administered by the LEI Regulatory Oversight Committee (ROC).
- In Canada, the LEI is requested for the identification of certain trading counterparties, in the reporting of all fixed income transactions on a confidential basis to the Investment Industry Regulatory Organization of Canada (IIROC).
- Operational divisions and branches are not eligible to receive a LEI and must, therefore, use the LEI of their immediate parent.
- On October 19, 2015, the LEI ROC launched a [consultation](#) on incorporating data on branches into the Global LEI System.
  - On November 16, 2015, the Investment Industry Association of Canada (IIAC), the Global Financial Markets Association (GFMA), the Institute of International Finance (IIF) and the International Swaps and Derivatives Association (ISDA) jointly submitted [comments](#) in a letter in response to the consultation.
  - Overall, **the Associations support the ROC's proposal to incorporate an identification approach for branches into the Global LEI System.** They agree there is a need for a global, standardized approach for the regulatory reporting of branches and branch activity, and the LEI system provides a good operational structure for this purpose.
  - The Associations voiced several concerns with the approach proposed by the ROC and made recommendations for addressing those concerns in the [submission](#).
  - Background information on the Global LEI System, regulatory uses of the LEI, and progress towards adoption of the LEI by legal entities worldwide is available [here](#).

## United States

### Municipal Advisor Conduct Rule Proposal

- The U.S. Municipal Securities Rulemaking Board (MSRB) creates rules of conduct, and standards of qualification, for municipal advisors.
- The Board's Proposed Rule G-42—*Duties of Non-Solicitor Municipal Advisors*—**prohibits a municipal advisor, or a broker dealer affiliate, acting as a principal in a transaction with a municipal issuer client for which the advisor is directly providing advice.**
- The large financial institutions noted that they have numerous affiliates conducting business with municipal entities, and these affiliates offer substantially different services and operate with distinct governance structures. **The effect of the principal transaction ban will be to discourage non-municipal advisor broker-dealers affiliated with a municipal advisor from conducting business with municipal entity clients.**
- On November 9, 2015, the MSRB filed with the U.S. Securities and Exchange Commission (SEC) an [amendment](#) to its Proposed Rule to respond to concerns. **The amendment provides a narrow exception to the proposed ban on certain principal transactions** (provided municipal advisors comply with three requirements) for transactions in specified types fixed income securities.
- Under Proposed Rule G-42, a municipal advisor is subject to a fiduciary duty that includes a duty of loyalty and a duty of care. The duty of loyalty requires, among other things, a municipal advisor to act in the municipal entity client's best interest without regard to the financial or other interests of the municipal advisor.

## Internal Revenue Service (IRS) Final Regulations re: Private Activity Bonds

- As a general rule, interest on State or local government bonds is taxable if the bonds are private activity bonds (i.e. the proceeds of the bonds are used for a private business use), unless a specific exemption is included in the Internal Revenue Code.
- **The IRS Final Regulations allow greater flexibility in the use of tax-exempt bonds to finance mixed-use projects** (i.e. the project is used for both a governmental use and private business use) and public-private partnerships.
- The final rules generally apply to bonds sold on or after January 25, 2016.
- More information is available in the November 9, 2015, Internal Revenue [Bulletin](#).

## Europe

### Open Letter to Bank of England Governor Mark Carney

- On November 15, 2015, **the Rt. Hon. Andrew Tyrie (Chairman of the Treasury Committee) wrote to Governor Carney asking the independent Financial Policy Committee at the Bank of England to provide its views on the risk of declining bond market liquidity**, and the gilt-edged market in particular.
- Mr. Tyrie noted there are reasons for concern that market liquidity may become stretched in the future and that financial stability and the infrastructure of the gilt market might be threatened.
- The ability of banks to act as market-makers is constrained by new restrictions on their proprietary trading and by higher risk weights applied to their trading positions.
- The capacity of market-makers to absorb fluctuations in supply and demand has been reduced, thereby affecting market liquidity. A substantial proportion of gilts is now held by investors who do not trade actively as liquidity providers, or who are constrained to hold gilts, so that their trading activity is confined to switching between gilts.
- Mr. Tyrie said market-makers will be reluctant to bid until they have confidence that the bottom has been reached. As a consequence, there may be large and sudden jumps in prices and yields. **A vicious circle of declining liquidity and financial distress among bond traders would be the consequence.**
- Mr. Tyrie requested that Mr. Carney provide a detailed response, particularly about the risks to market liquidity.
- Mr. Tyrie's letter can be read [here](#).
- Mr. Carney and the Bank of England have not yet responded.

### MiFID II Delay

- On November 27, 2015, the European Parliament's *Markets in Financial Instruments Directive* (MiFID II) negotiation team informed the European Commission that it is **ready to accept a one-year delay for MiFID II implementation**, provided the Commission finalizes the implementing legislation swiftly and, thereby, takes into account the European Parliament's priorities, and the Commission and the European Securities and Markets Authority (ESMA) come up with a clear roadmap on the implementation work, especially for setting up the IT systems.
- MiFID II was slated to come into force January 3, 2017, but now looks set to be delayed to January 3, 2018. The postponement still requires the approval of the European Council—the institution that sets the EU's political direction and priorities.
- The totality of the MiFID [text](#), comprising some 1,500 pages, reflects the vast scope of the rules and the complexity of implementing an ambitious legislative package. **The timeline to implement the rules and build the necessary IT systems is considered extremely tight and challenging for both market participants and regulators.**

- MiFID II broadens the pre- and post-trade transparency rules to include bonds. ESMA also adopted an instrument-by-instrument approach to assess liquidity on individual bonds. The liquidity test will be performed at the end of each quarter and will depend on bond type, issuance size and issuance date.
- Details for trades in individual bonds will be made public if the average daily amount traded is at least €100,000, there are at least two trades daily (on average), and trades take place on at least 80 per cent of trading days.

### European Commission Revamping Prospectus Regime

- As part of its Capital Markets Union action plan, on November 30, 2015, the European Commission announced that it is [revamping the prospectus regime](#) in the EU.
- No EU prospectus will be required for capital raisings below €500,000.
- **A tailored disclosure regime will help SMEs and companies with a reduced market capitalisation access capital markets without the burden of doing a full prospectus.** The existing threshold for SMEs who can take advantage of it will double—from €100m market capitalisation to €200m.
- Companies already listed on a public market that want to issue additional shares, or raise debt, will benefit from a new, simplified prospectus.
- **Frequent issuers can benefit from a fast-track approval** when choosing to draw up an annual "universal registration document" containing all the relevant information about the issuer.
- The European Securities and Markets Authority (ESMA) will, for the first time, **provide free and searchable online access to all prospectuses approved in the European Economic Area.**
  - Investors will benefit as they will have a single portal where they can find information on companies that have listed shares or corporate bonds on markets where the general public can invest.
  - A uniform prospectus requirement for bond issuances, irrespective of denomination sizes, provides an incentive for all issuer of debt to choose denomination sizes that make their bonds more attractive for a wider range of investors.
  - A wider range of investors, in turn, is expected to increase buying and selling interest in bonds, thus increasing the liquidity of corporate bond markets in the EU.

### New Pan-EU Database on Suspensions and Removals from Trading

- On November 17, 2015, The European Securities and Markets Authority (ESMA) launched a **new database which makes available information on suspensions and removals from trading**, including restoration details that national supervisory authorities have to notify under the *Markets in Financial Instruments Directive* (MiFID).
- The system covers financial instruments admitted to trading in European regulated markets, and displays a list of current suspensions in these markets. The [system allows searching](#) for an instrument (already suspended in the past or currently suspended) and the details of the suspension.

### Solvency II Requirements

- European insurers are facing a more complex regulatory environment. New risk capital requirements, known as [Solvency II](#), are slated to come into effect on January 1, 2016. The framework will follow the Basel Accord approach.
- **Insurers in all 28 EU Member States must prove they have enough capital to withstand a one-in-a-200-year financial shock and still meet future obligations to policy holders.**

- Some insurers have secured regulatory approval for their customised “internal models”, allowing them to use their own methods of calculating risks within the business to set up capital buffers. Other insurers will adopt the “standard model” which could see them hold more capital.
- **New insurance restricted tier one bonds are likely to be issued and will count towards an insurance company’s capital.** They can be converted to shares or written down if an insurer’s solvency ratio falls below a certain level. Convertible bonds blur the boundaries between bonds and shares—coupons on bonds are typically paid out of a company’s pre-tax profits whereas the dividend payments come out of post-trade profits.
- In the U.K., authorities are close to accepting convertible tier one insurance bond coupons as tax deductible, making it more attractive for insurers to issue such bonds. There is no pan-European approach.
- Overall, insurers will have flexibility to choose whether to issue restricted tier one bonds alongside equity. Only 20 per cent of their tier one capital should be restricted tier one bonds.
  - Solvency II is on the radar of insurance companies across the globe. Everyone is watching to see how the EU transforms its insurance industry and implements risk-based improvements to protect policyholders.
  - As the process unfolds, it will be important to monitor the potential impact to insurance companies, governments and rating agencies within the EU and beyond.

## Asia

### **China Removes Bond Issuance Limits for Companies**

- On December 2, 2015, China’s economic planning agency, the National Development and Reform Commission (NDRC), announced that it is **removing annual caps on the number of onshore bonds local companies can issue.**
- The new streamlined regulations will apply to issuers of corporate debt rated AA and above.
- China also announced new rules that allow up to 40 per cent of bond issue proceeds to be used to pay off bank loans and supplement operating capital. Issuers will not be able to reinvest proceeds from bond sales into stocks.
- The NDRC also said that its ultimate goal was to transform the bond issuance into a registration-based system from an approval-based one.
  - The move is seen as an attempt to improve declining asset quality as a more liquid and longer-dated bond market will help corporates better manage borrowings and banks better manage non-performing loans.

### **India Proposes New Rules to Govern the Issuance of Green Bonds**

- India is looking to introduce innovative financial instruments to leverage a wider investor base such as pension funds, sovereign wealth funds and insurance companies to invest in the infrastructure sector.
- On December 3, 2015, the Securities and Exchange Board of India (SEBI) proposed new [green bond regulations](#).
- Issuance of green bonds does not require any amendment to the existing SEBI regulations for issuance of corporate bonds, however, **for designating an issue of corporate bonds as green bonds, an issuer would have to comply with additional reporting requirements** based on the International Capital Market Association’s document [Green Bond Principles, 2015](#), in addition to requirements under *Issue and Listing of Debt Securities Regulations*.
- The issuer would have to define and disclose in their offer document the criteria for identification as ‘green’, the process to be used to apply ‘green’ criteria to select specific projects or activities, and how proceeds will be managed. **Green bond-funded projects will be evaluated and progress reported against both environmental and financial criteria on an annual report.**

# ***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. See the [Highlights of Our Achievements](#) report.

The IIAC's efforts have assisted Member firms address:

- CRM rule-making and managing industry CRM compliance effort
- 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.

## **Trip Around the IIAC—December 2015**

- **The Culture Agenda.** The Investment Advisor code of conduct and the full panoply of rules oblige advisors to serve the best interests of their clients. Post-CRM, the focus will likely be on improving conduct and behaviour across the wealth management sector. This entails mandating continuing education in dealing with elderly clients and ethics, expanded industry good business practices, and encouraging better firm culture through guidelines to improve “tone at the top”, accountability, communication and aligned incentives.
- **Cybersecurity.** The IIAC agenda includes expanding industry awareness of the cyber threat, providing member firm discounts for cybersecurity related vendors, presenting educational seminars, and working with the regulators and the cybersecurity industry to develop best practices.
- **Cooperative regulator.** The IIAC will comment on proposed legislation and regulation in the *Capital Markets Act*. In addition to more efficient regulation for capital markets activities and a voice for Canada on the international stage, the regulatory staff will be fully accountable to an expert business-oriented Board of Directors. The outcome will be securities regulation linked to our strategic national economic and financial agenda.
- **Venture Markets.** The IIAC has coordinated a working group comprised of the regulators (including the ASC, BCSC and IIROC) and TSX Venture Exchange, and buy-side and sell-side representatives to examine technical adjustments to trading practices, possible areas for tax related incentives, and clarification of regulatory obligations to meet the suitability standard for speculative securities to help revitalize the Canadian venture markets.
- **Technology and Operations Committee.** The IIAC is forming a new standing committee, the Technology and Operations Committee, to provide a forum for member firms to discuss emerging technology issues in the investment industry and collaborate on selective projects to reduce costs and improve efficiencies.

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