From the Desk of Ian Russell
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IIAC Fixed Income Market Regulatory Update – July 28, 2016

Canada

Minutes from the Most Recent (June 20) Bank of Canada Canadian Fixed-Income Forum (CFIF)

- Participants discussed developments, regulation and transparency in the fixed income markets.
- **Fixed-income market liquidity was characterized as satisfactory**, but somewhat more variable across asset classes.
- **Foreign portfolio inflows into the Canadian market were described as reasonably strong**, but not as strong as some forum participants expected, given the number of securities trading at negative rates globally.
- It was noted that **increased provincial issuance was relatively well received**; however, a participant noted that it was marginally more difficult to find an appropriate time window for a successful new bond issue.
- Forum participants described Government of Canada benchmark bond liquidity as good across the yield curve. However, there had been **some reduction in liquidity for off-the-run Government of Canada bonds**, particularly those maturing in more than 10 years.
- Canada's **ETF bond market was described as primarily a "create and redeem" market** whereas, in the U.S., the vast majority of the activity takes place in the secondary market.
- Participants discussed CanPX's recent decision to cease operation of its corporate and government bond transparency systems on October 1, 2016. **Some buy-side members expressed concern that the termination of CanPX would reduce the current level of trade transparency for the government markets**, as CanPX will no longer disseminate the pre- and post-trade government debt data that it received from the inter-dealer bond brokers.
- Ontario Securities Commission (OSC) staff acknowledged the concerns raised, but noted that CanPX was an information processor for corporate debt securities only—currently there are no transparency requirements for government debt securities in place (an exemption is in force until January 1, 2018). The government debt data that CanPX received and disseminated was provided to CanPX on a voluntary basis by the inter-dealer bond brokers. CanPX's decision to end its operations, including the government debt reporting, was outside regulatory purview. OSC staff indicated that **the process to determine what regulatory requirements are needed for government debt transparency will commence in the near future**.
- **IIROC** recognizes that a number of members of both the buy-side and issuer communities felt that CanPX's services had provided value to the system and **was prepared to consider expanding the scope of its existing transparency efforts** to meet those needs, if requested by the applicable authorities.

United States

FINRA Proposes Trade Reporting for U.S. Treasuries

- The Financial Industry Regulatory Authority (FINRA) filed with the U.S. Securities and Exchange Commission (SEC) a proposed rule change to **expand the Trade Reporting and Compliance Engine (TRACE) to include most secondary market transactions in marketable U.S. Treasury securities**.
- Transactions involving U.S. Treasury bills, notes, and bonds would need to be reported to TRACE by the end-of-day on the trade date (T+0). If the trade occurs after 5 p.m. ET, both parties would have to report the trade no later than the next business day (T+1).
- The proposal does not require transactions that are a part of the U.S. Treasury's auction process, or transactions in U.S. Treasury savings bonds, to be reported to TRACE.
- **FINRA only seeks to collect transaction information—**not to disseminate it to the public.
- Data compiled will include the price and size of the transaction; its date of execution; counterparty identifiers; whether the party is acting as a principal or agent; and the trade's commission and settlement date as well as the reporting-side broker or the contra-party introducing broker in case of a 'give-up' trade.
- The full FINRA proposal is available here.

Europe

The International Capital Market Association (ICMA) Publishes Second Study on the State and Evolution of the European Corporate Bond Market

- The study represents the views of market stakeholders, including asset managers, liquidity providers, issuers, and intermediaries.
- The main findings of the new ICMA corporate bond market study are:
    - It is **increasingly difficult to trade in large sizes, to execute orders quickly, or to establish reliable prices**.
    - European corporate issuers are increasingly concerned about the state of the corporate bond secondary market. The **disconnect between primary market stability and secondary market liquidit**y directly impacts their ability to raise capital necessary to fund investment.
    - While sell-side firms continue to reshape their models around balance sheet efficiency, the **buy-side is taking more initiative in terms of locating and creating liquidity**.
    - Technology is playing an increasingly important role in the market.
- The study makes a number of recommendations, which could improve the long-term efficiency and functioning of the European corporate bond markets.
    - Policy makers and regulators should **consider less stringent capital charges**, notably charges for hedging and financing.
    - **The single-name credit default swaps (CDS) market should be revitalized**. Single-name CDS not only provide an efficient and standardized tool for market-makers and investors to hedge credit exposures, but given its close relationship with the underlying reference bonds, an active and liquid single-name CDS market could help stimulate liquidity in the corporate bond market.

    - **CDS market-makers have been reduced to only three or four over the past year or so**, and volumes have been in steady decline, despite an effort to revitalize the market in 2014 with a re-design of CDS contracts to make them simpler, more standardized, and more 'bond like' in terms of their economic features. A number of dealers felt that if **liquidity could be re-injected into the single-name CDS market**, this would almost certainly have a positive knock-on effect for corporate bond market liquidity.
    - **A review and re-assessment of harmful regulation should be conducted**.
    - Investors and asset managers, corporate issuers, banks and broker dealers, intermediaries and infrastructure providers, associations and representative bodies, as well as policy makers and regulators, need to work together in a formalized and structured forum to **share views and ideas on market structure and development**.
- You can read ICSA's full report by clicking here.

Asia

East Asia Pacific Central Banks Reinvest Asian Bond Funds

- A Group of 11 central banks and monetary authorities in the East Asia and Pacific region (representing Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, Philippines, Singapore, and Thailand) is **closing its U.S.-dollar denominated bond fund** (i.e. the Asian Bond Fund or ABF1) and **transferring the investment to a local currency-denominated bond fund** (ABF2) to support local-currency bond market development.
- Local currency-denominated bonds issued in Japan, Australia and New Zealand are excluded from the ABF2.
- The ABF2 provides central banks a diversified regional investment product for their reserves management and promotes regional central bank cooperation. It aims to bring real benefits to domestic capital market in Asia by promoting fixed income investment and providing an impetus for improving market infrastructure.
- The Bank for International Settlements (BIS) is the fund administrator for the Group's investments in ABF2.

China Tightens Corporate Bond Borrowing Rules

- **Chinese authorities have tightened rules on leverage in the corporate bond market**, amidst rising defaults and near-defaults by state-owned enterprises (SOEs). SOEs' government backing had been considered a guarantee of prompt and full payment.
- China Securities Depository and Clearing Corp. (CSDC) **lowered ratios that determine how much investors can borrow to buy new notes using holdings of exchange-traded company debentures as collateral**.
- Investors using securities whose bond and issuer ratings are AA can now count 50% of the value of those debentures as collateral, down from 70%.
- The government may announce more rules to curb leverage.
- The regulation will lead to an increase in borrowing costs in the primary market. It will be more difficult for lower-rated issuers to sell bonds.
- Additional information is available from Bloomberg news.

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. Click on the links to read the Highlights of Our 2015 Achievements and the Highlights of Our Q1, 2016 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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