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

IIAC Fixed Income Market Regulatory Update – May 31, 2016

Canada

Minutes from the Most Recent (April 25) Bank of Canada Canadian Fixed-Income Forum (CFIF)

- Forum participants noted significant improvement in overall market conditions.
- **Fixed-income liquidity has been improving**, but it is still affected by reduced dealer market-making capacity.
- The relatively poor conditions in the corporate primary market at the beginning of the year have largely unwound. Conditions in the public sector primary market are relatively healthy, with an increase in demand for frequent issuers. **Investors are seeking liquidity**, preferring liquid benchmark issues over private placements and floating-rate notes.
- The CFIF will be conducting **a survey of market participants to better understand liquidity, transparency and market access in the Canadian fixed-income market**, and identify trends or issues in the market that would benefit from further analysis. The survey will also engage market participants regarding possible approaches to improve market functioning.
- The next meeting of the CFIF is scheduled for June 20, 2016.

Canadian Capital Markets Association (CCMA) Consulting on Identification of Asset Classes That Will Be Affected by the Shortened 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, thereby reducing counterparty risk.
- **Canada has committed to shortening the securities settlement cycle** from the current three days (T+3) to two days (T+2) by the third quarter of 2017 to align with the U.S.
- IIAC staff and IIAC members have been participating on various external committees organized by the CCMA to assist in the move to T+2.
- The **CCMA has been consulting on the identification of asset classes that will be affected by the shortened settlement cycle**. The Draft T+2 Asset List includes the following fixed income assets for transition to T+2: corporate bonds; municipal bonds; provincial bonds; federal bonds (term over three years); convertible bonds; Asset-Backed Securities; strips, coupons and residuals; and most fixed income funds.
- Comments received will be reviewed by members of the CCMA's T+2 Steering Committee. Following their confirmation of appropriate amendments, the asset list will be republished as "final', with a target date of June 30, 2016. As industry participants progress towards the T+2 transition, there may be further clarifications needed.

- The Canadian Securities Administrators (CSA) has sent a letter to Canadian head-quartered registered firms encouraging registrants to prepare for the transition to T+2 on September 5, 2017 and to raise any specific concerns related to the transition.

Europe

Call for Evidence on EU Regulatory Framework for Financial Services

- Since the Global Financial Crisis there have been 48 pieces of European Union legislation in financial services and many more delegated and implementing acts. Some rules have yet to be fully implemented and much detail still to be finalized.
- The European Commission launched consultations—Call for Evidence—and requested stakeholders **submit evidence on how rules: 1) affect the ability of the economy to finance itself and grow; 2) result in unnecessary regulatory burdens; 3) interact and create inconsistencies in the rules framework; and 4) give rise to unintended consequences**.
- In launching the Call for Evidence, the Commission has not been acting in isolation. The G20, the Financial Stability Board and the Basel Committee are all looking at the coherence of the reforms that have been undertaken in recent years. Mark Carney, Chairman of the Financial Stability Board, put it well when he said: "monitoring implementation of agreed reforms, analyzing the effects of the measures, and making adjustments to address any identified material unintended consequences, represents good regulatory practice."
- On May 17, 2016, **IIAC President and CEO Ian Russell attended a public hearing in Brussels** on the Call for Evidence 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. Attending with Mr. Russell was Peter Eisenhardt, Secretary General, ICSA.
- **The Commission is serious about "better regulation"**. It realizes the **regulatory program following the crisis was rolled out in haste, and inevitably in silos**. The probability that they got everything right is zero. The regulators intend to make suitable regulatory amendments, if the evidence points to excessive regulation.
- Submissions that repeated old arguments, particularly with respect to capital requirements, have little sway with the Commission. Specifically, the EU is not prepared to pare back the Basel rules and undermine hard-won financial stability in the banking system.
- Submissions that suggested there may be a good reason to review existing or future regulation, in particular elements of the Capital Requirements Regulation (CRR)—such as Leverage Ratio and European Market Infrastructure Regulation (EMIR)—have sway with the Commission.
- Lord Hill, EU Commissioner for Financial Stability, Financial Services and Capital Markets Union, added that the **EU will conduct a "comprehensive review" of liquidity in corporate bond markets**. In addition to the review, "when it comes to new measures, we'll be careful to avoid anything that could make the situation more difficult," he said.
- He has written to the European Securities and Markets Authority (ESMA) to request a "more cautious approach" to determining bond liquidity for transparency rules in MiFID II (see below).
- The European Commission is expected to publish a summary report on the Call for Evidence in July 2016.

MiFID II – New Phase-In Regime

- The European Securities and Markets Authority (ESMA)'s final draft Regulatory Technical Standards incorporate an instrument-by-instrument approach to assess liquidity on individual bonds. Bonds are deemed liquid if the average daily notional amount traded is at least €100,000; the bond trades at least twice a day, on average; and the bond trades in at least 80% of the trading sessions available.
- The European Commission requested ESMA **phase-in over a four-year period the application of certain parts of this new pre- and post-trade transparency regime** to avoid impeding bond market liquidity.
- The Commission objected to ESMA's proposed standard of two trades a day for determining whether an instrument is liquid and subject to the transparency rules. The Commission called for an initial threshold of **15 trades a day**, falling to **two trades a day** in year four. ESMA agreed and amended the MiFID II standards.
- The date of application of MiFID II has been delayed to Jan. 3, 2018. The 15-trade level would apply until May 15, 2019. It would fall to 10 trades in year two, seven trades in year three, and the two-trade threshold would apply from May 16, 2021.
- Consequently, significantly fewer instruments than initially proposed would be subject to the real-time transparency regime at the start of MiFID II—roughly 1,100 instruments in year one, 1,500 in year two, 1,900 in year three and 2,600 in year four.
- The automatic phase-in would be accompanied by an annual liquidity assessment by ESMA. The Regulatory Technical Standards would be amended in case of significantly negative impacts on liquidity.

Brexit: Implications for Capital Markets

- Paul Richards, Managing Director and Head of Market Practice and Regulatory Policy at the International Capital Market Association, expects **considerable uncertainty in capital markets if the UK votes to leave the EU, and even prior to a vote** is the expectation is the UK will vote to leave.
- The **uncertainty will likely last for two years**, and could last longer, until a withdrawal agreement is reached with the rest of the EU.
- Financial institutions in the UK heavily dependent on EU business would have the opportunity, if they wished, to reduce uncertainty by shifting at least of some of their EU business (and staff) to other locations in the EU.
- Leaving the EU is not expected to lead to less capital markets regulation in the UK. While the detailed regulations affecting capital markets in the UK are set at EU level, the overall framework for capital markets regulation is set at the global level by the G20. The UK would need to continue to meet these global standards, even if it left the EU.
- The UK would need to continue to comply with the terms of EU regulations, if it wanted to obtain the most favourable terms of access to the EU Single Market after leaving the EU.
- To find out more about the implications of a Brexit on capital markets, please click here.

United States

U.S. Department of the Treasury Provides an Update on Liquidity Conditions in the Treasury Market

- U.S. Department of the Treasury officials stressed that **liquidity in the Treasury market is consistent with historical levels; however, the data only reflect a portion of transactions in the inter-dealer market**—i.e. electronic platforms where traditional dealers interact with each other and, increasingly, with principal trading firms. Access to data related to transactions in the dealer-to-customer market remains limited.
- In general, **average daily trading volumes are well within recent averages; bid-ask spreads have remained tight over the last five years; average trade sizes for most Treasury securities with longer tenors have been stable**.
- **Market depth has declined somewhat since early 2013**, which may have implications for the ability of market participants to trade large blocks of Treasuries. However, this trend is most notable in 2-year securities. Current market depth is near average levels observed over a longer historical period.
- Treasury market liquidity appears to diminish most around the release of market-moving economic news (e.g. FOMC statements and employment data), but outside these events, liquidity appears largely stable.
- Additional measures on the state of Treasury market liquidity are available here.
- You may also be interested in the Bloomberg article: "Treasury Rebuffs Wall Street Concern Over Bond Market Liquidity".

Federal Reserve Bank of Chicago President and CEO writes to the U.S. Department of Treasury

- In a letter to the U.S. Treasury Department as part of its request for comments on the evolving nature of the government bond market, Charles Evans noted there are groups dedicated to discussing safeguards and best practices for bonds, but no chief regulator.
- The Inter-Agency Working Group for Treasury Market Surveillance monitors trading in the when-issued and other secondary markets for Treasury securities and Treasury futures markets. Other forums, like the Treasury Market Practices Group (a Federal Reserve Bank of New York sponsored group), make recommendations for best practices related to trading, settlement and risk management in the Treasury markets.
- Mr. Evans said **regulators that monitor trading in U.S. debt should coordinate their efforts to make the Treasury market's rules more consistent—specifically, to harmonize trading, clearing and reporting requirements**. He also called for a comprehensive analysis of U.S. Treasury markets, including the complex regulatory structures found in these markets.

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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