From the Desk of Ian Russell
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IIAC Fixed Income Market Regulatory Update – November 2, 2015

Canada

Regulation and Transparency of the Fixed Income Market

- The Canadian Securities Administrators (CSA) is proposing that trading data on all corporate-debt securities be made public commencing mid-2016, replacing the dealer-owned system (CanPX) that provides public data on less than half of Canadian corporate securities.
- The proposed transparency model for debt securities is designed on the foundations of the IIROC model for debt market surveillance (MTRS 2.0 – see section below).
- Regulators are proposing trade information, including price and yield, be made public between one and two days after the trade goes through, along with volume cap. Amounts will not have to be reported for trades above $2 million for investment grade bonds or above $200,000 for high yield trades. More information on the CSA's proposal is available here.
    - There is a definite need for extensive industry consultation as this proposal moves forward, given the chronic weakness in corporate bond liquidity and structural and behavioural changes in the market-place.
    - The initial proposal is an unprecedented effort to expand transparency as many illiquid high-yield bonds are included. Many of these bonds are not distributed to retail investors.
    - The CSA proposes to expand transparency over time by shortening the settlement period from two days to one day, or perhaps even intraday. This will increase balance sheet exposure to market-makers, particularly for illiquid bonds. Moreover, this expanded transparency approach would require significant technical changes to the new debt reporting system, adding to overall costs, and would provide minimal benefit as many thinly traded corporate bonds are not purchased by retail investors.
    - The CSA is also considering expanding the transparency framework to require Exempt Market Dealers (EMDs) to report corporate debt trades into IIROC. EMDs should be subject to CSA transparency requirements, similar to IIROC registrants, if they trade bonds in secondary markets to ensure fair treatment and a competitive playing field among all market registrants.
    - The proposal is silent on the funding for the new transparency data. If regulators decide to commercialize the transparency data, the investment industry is entitled to resulting revenues given its involvement in creating the data and building the dissemination technology.
    - The IIAC has prepared a detailed response to the CSA consultation. Click here.
    - See the Financial Post for IIAC comments on the proposed transparency system.

IIROC Debt Market Surveillance

- Commencing November 1, 2015, Government Securities Distributors will need to report trade information for all fixed income transactions to the Investment Industry Regulatory Organization of Canada (IIROC) so it can monitor the market. All other dealers will be required to report commencing November 2016.

- Dealer Members are required to report debt securities transactions to IIROC through the Market Trade Reporting System 2.0 (MTRS 2.0), a secure web portal.
- The ongoing operation and maintenance of the surveillance framework will be funded by IIROC dealers trading in domestic debt markets. Details can be found here.

United States

Bond Market Liquidity

- In remarks to the SIFMA Liquidity Forum on September 30, 2015, Reserve Bank of New York President and CEO William Dudley noted that some opponents of tougher bank regulation claim that the increased regulatory requirements, such as the higher capital requirements and new liquidity standards, have reduced these firms' market-making capacity. Mr. Dudley does not believe the hypothesis is well-supported by the available evidence. However, he did say there are reasons to think liquidity risk may have increased, and there are some data to support this conjecture. Mr. Dudley's speech is available here.
    - The IIAC conducted a small, informal survey of our members on the bond market liquidity situation in Canada. Respondents indicated that market liquidity has become less reliable in the government sector and has diminished significantly in the corporate bond secondary market.
    - On September 30, IIAC President & CEO Ian Russell sat down with Michael McKee and Kathleen Hays on Bloomberg Radio to talk about the deterioration in bond market trading conditions in Canada; the differences between the Canadian and U.S. markets; the contributing factors to decreased liquidity; what regulators can do to ameliorate the liquidity crunch; and the implications for fixed income investors. You can listen to the radio interview here.

Municipal Securities Rulemaking

- The Municipal Securities Rulemaking Board (MSRB) proposes that U.S. municipal securities dealers disclose to their retail customers the amount of their mark-up from the prevailing market price, when the dealer makes a corresponding trade within two hours of the customer trade. The mark-up disclosure proposal seeks to enhance the transparency of investor transaction costs and dealer compensation, and is the first proposal of its kind in over 20 years. The MSRB's request for comment document is available here.

Exclusion of Municipal Bonds From the Definition of High Quality Liquid Assets

- On October 21, 2015, witnesses appeared before the U.S. House Subcommittee on Financial Institutions and Consumer Credit and voiced concern over U.S. municipal bonds being excluded from the definition of Level 2A High Quality Liquid Assets (HQLA) in the final Liquidity Coverage Ratio (LCR), while certain foreign sovereign bonds are included.
- Inclusion of municipal securities in the definition of HQLA will require an amendment to the *Federal Deposit Insurance Act*.
- One of the key reforms of Basel III, the Liquidity Coverage Ratio (LCR), requires banks to hold an adequate amount of unencumbered 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.
- Momentum is building to classify U.S. municipal bonds as HQLA.
- You can read the testimony here.

Europe

Bond Transparency Requirements of MiFID II

- The European Securities and Markets Authority (ESMA) published final technical standards, including the *Markets in Financial Instruments Directive* (MiFID II) which takes effect on January 3, 2017.
- For Europe's biggest brokers, the transparency requirements of MiFID II will touch almost all of their trading activities. 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.
- ESMA also adopted an instrument-by-instrument approach to assess liquidity on individual bonds and review thresholds as they trade. The liquidity test will be performed at the end of each quarter and will depend on bond type, issuance size and issuance date.
- The legislation was described as a "massive data challenge". Most of the bonds affected are sovereign securities. More information on MiFID II is available here and here.
    - The EU pre-and post-trade reporting requirements go further than the U.S.'s TRACE bond-price reporting system, where trades are reported only after they have taken place. EU requirements also go further than the Canadian Securities Administrators proposal (CSA) to increase post-trade transparency for corporate debt securities.

Central Securities Depositories (CSD) Regulation

- On September 28, 2015, the European Securities and Markets Authority (ESMA) published final technical standards on CSD Regulation designed to harmonize the authorisation and supervision of CSDs within the EU. You can view the Final Report here.
- It also introduced a settlement discipline regime, including measures to prevent and address settlement fails, such as a mandatory buy-in and cash penalties.
- It is now expected that ESMA will finalize the regulatory technical standards for mandatory buy-ins by year-end 2015.
- ESMA recommended that implementation of CSD Regulation Settlement Discipline (including mandatory buy-ins) be postponed for 24 months (meaning September 2017), allowing for the successful implementation of TARGET2-Securities.
- CSDs are systemically important securities infrastructures (trading venues, central counterparties, trade repositories and central securities depositories) that allow the registration, safekeeping, settlement of securities in exchange for cash and efficient processing of securities transactions in financial markets.

EU Covered Bond Market

- The European Commission launched a consultation on proposed action to address the legal and practical issues in the EU covered bond market to facilitate cross-border investment within the EU and from third countries.
- Currently, there are different legal frameworks and supervisory practices across EU Member States for covered bonds.
- The Commission is proposing a more integrated (i.e. harmonized) EU-wide covered bond framework that could be reflected in legislation and/or a set of recommendations. The EU Covered Bond consultation paper is available here.

Asia

ASEAN Common Prospectus

- On March 3, 2015, securities regulators in Singapore, Thailand and Malaysia jointly signed an MOU to establish a *Streamlined Review Framework for the ASEAN Common Prospectus*.
- In early September 2015 they issued a handbook to implement the Framework, including common disclosure standards that will enable issuers to issue plain debt securities in the three countries with a single prospectus. Regulators have agreed to coordinate the review process and to rely on home regulators' views to the extent possible.
- Issuers planning to offer plain debt securities can now expect shorter time-to-market, thereby reaping both cost and time savings, and faster access to capital across signatory countries.
- The regulatory requirements of the *Streamlined Review Framework* align more closely to U.S. and European norms. More Asean countries are expected to follow suit.
- Australia, one of the world's easiest and quickest markets for companies to raise debt, is facing increased pressure to adopt tighter (and more onerous) global standards in its bond market as its Asean peers adopt stricter international standards.
- More information is available here.

Japan Bringing Greater Transparency to Corporate Bonds

- On November 2, 2015, the Japan Securities Dealers Association (JSDA) launched a system that requires the Japan Securities Depository Center (JASDEC) to divulge corporate bond traded prices on a daily basis, covering approximately 1,200 bonds.
- Up until now, corporate bond price data was based on indication prices from brokerages, as Japan lacked a system that disclosed real-time corporate bond transactions, resulting in reduced transparency.
- The JSDA will only disclose trades that exceed 100 million yen (C$1.085 million) on bonds that are rated AA or above by two or more rating agencies.
- Currently, about 45% of corporate bond issues are rated AA or higher.