

October 30, 2015

Attention:

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RE: CSA Staff Notice 21-315: Next Steps in Regulation and Transparency of the Fixed Income Market

The Investment Industry Association of Canada (IIAC or Association) appreciates the opportunity to provide comment on CSA Staff Notice and Request for Comment 21-315 *Next Steps in Regulation and Transparency of the Fixed Income Market* (the Notice). Among other things, the Notice outlines a proposed new transparency framework for domestic corporate debt markets (the Proposal). The IIAC is well suited to comment on the Proposal given our long standing role as secretariat for the current Information Processor for corporate debt markets and our members' deep understanding of the functioning of this market. An industry working group of IIAC Member firms active in corporate fixed income markets assisted in the evaluation of the proposed framework and Notice. A primary focus of our review was in identifying the potential for unintended consequences stemming from the Proposal, such as the impact of increased transparency on liquidity.

Effective oversight of Canadian debt markets and investor access to fixed income information serve to foster confidence in our markets. The IIAC, therefore, commends the CSA and IIROC for devoting increased attention to these areas. We are also pleased that the CSA shares the IIAC's long held view

that the optimal approach for increasing debt market transparency balances investor need for information with concerns of the impact too much transparency can have on liquidity and market functioning generally.

The CSA proposal gives responsibility for transparency to a regulatory authority, IIROC, and will further extend the transparency reach across the corporate bond markets. This is a material departure from the existing regime. As the project moves forward to implement the new framework, therefore, regulators need to be sensitive to the delicate balance between transparency of information and market liquidity and efficient functioning, particularly given the existing conditions in Canada's debt markets. Moreover, the design of the new transparency framework should take into account the availability of corporate bond data from alternative sources, including information already made available into the market from individual dealers and information vendors. The new framework should also not ignore changes to the underlying behaviour of retail investors, paying increased reliance on managed fixed income products and less on individual corporate debt securities.

The Proposal also comes at a time when global financial markets have become more fragile and uncertain. Measures of fixed income market volatility have increased and conditions in North American credits markets have eroded since earlier in the year evidenced by widening in credit spreads. The liquidity of global credit markets has also been an area of increased attention and concern for market participants and authorities as new regulations, as well as changing attitudes on risk, have impacted dealers' market making activities. Given this backdrop, it is imperative that any new transparency framework in Canada be carefully structured and implemented as not to further retrench dealers and exacerbate prevailing market sentiment.

While the IIAC is pleased that the CSA has considered the uniqueness of the Canadian market when formulating the Proposal, we have identified some concerns as well as opportunities to improve on the proposed transparency framework such that it does not impede on efficient market functioning while still delivering enhanced price transparency to investors.

Proposed timeline to implement post-trade transparency for corporate debt securities

The Proposal targets mid 2016 for phase one implementation and indicates the specific dates of the transparency implementation phases will be confirmed before the end of 2015 and subject to the readiness of IIROC's new fixed income reporting platform (MTRS 2.0) and the corresponding transparency system. The initial implementation date of mid 2016 is ambitious given the Proposal's heavy reliance on MTRS 2.0 – a platform designed and built for the primary purpose of market surveillance and which does not even go live until November 2015.

Given the volume and complexity of data expected to go through MTRS 2.0, we believe the Proposal underestimates the effort involved before MTRS 2.0 finds itself in 'steady state'. Only when there is full confidence in the platform as a surveillance tool should it be leveraged for public transparency purposes. Efforts must be taken to ensure inaccurate trade information is not publicly disseminated. Whether sufficient confidence in MTRS 2.0 can be achieved, and the corresponding transparency system developed and tested by mid-2016 is highly uncertain.

We expect IIROC to establish a process in place for monitoring the roll-out of MTRS 2.0 and any issues that might arise impairing the integrity of the data. We believe the CSA would be in a better position to establish a phase one implementation date in the New Year after MTRS 2.0 has had more than just a few weeks of operating history and the CSA has greater visibility into potential issues. We think a more suitable implementation date may be after November 1, 2016. Not only would this give the CSA and IIROC a few extra months to ensure the integrity of the transparency system but it would also coincide with the planned phased two launch of MTRS 2.0 when all IIROC dealers will be required to participate resulting in a more comprehensive transparency system.

Volume Caps

We support the Proposal's use of volume caps on individually traded debt securities to protect the anonymity of large-sized market transactions. We witness the use of volume caps in other foreign transparency systems and they have been utilized by Canada's existing Information Processor for corporate debt markets, CanPX, since its designation in 2003. The Proposal sets volume caps at \$2million for investment grade corporate bonds and \$200,000 for non-investment grade corporate bonds, consistent with CanPX. This distinction in volume caps between investment grade and non-investment grade bonds is important given their respective differences in trading patterns and investor composition. We recommend, therefore, that the proposed volume caps be maintained.

Dissemination Delay

The Proposal indicates that trade information will be publicly disseminated no earlier than on T+1 and likely, on T+2, with the objective to reduce the delay over time. The IIAC views a sufficient delay in dissemination of trade information as important for protecting the integrity of the dealer market-making function. The challenge for regulators is to find the right length of delay that gives investors timely information without jeopardizing market liquidity. Optimum dissemination delay depends on the liquidity characteristics of the corporate bond which can vary considerably among sub-categories of these securities. For example the liquidity of high-yield corporate bonds generally varies considerably from that of investment grade corporate debt.

The current Information Processor for domestic corporate debt markets, CanPX, addresses the situation above by focusing its transparency efforts on the most liquid universe of corporate bonds¹. CanPX provides price transparency on approximately 450 designated corporate debt securities. These designated bonds are estimated to account for approximately two-thirds of corporate bonds traded.

The CSA has taken the view that all corporate bonds traded in the domestic markets should be subject to transparency. If the CSA takes this approach and includes highly illiquid corporate debt securities in the transparency regime, the T+2 delay may not be sufficient for these bonds, given the transaction infrequency and likelihood of dealer balance sheet exposure for extended periods. Without a larger

¹ A list of CanPX designated bonds, including end of day pricing, is available at www.CanPXonline.ca/quotes.php

dissemination delay dealers are less likely to engage in transactions of highly illiquid corporate bonds for clients.

As the CSA is aware, other transparency services in Canada provide a dissemination delay of 14 days for less frequently traded securities, a practice which has generally been accepted by the IIAC.

We recognize a potential challenge stemming from our recommended approach above is in identifying which bonds are less-liquid and hence should be subject to the lengthier delay in dissemination. There are various approaches the CSA or IIROC can consider:

1. The CSA could categorize all non-investment grade corporate debt securities (including any security without a credit rating) as “less liquid” and, therefore, subject to an extended delay in dissemination. This acknowledges the uniqueness of Canada’s high yield market.
2. The CSA could undertake an analysis of the trading of individual corporate debt securities from the MTRS database. The CSA could establish various “liquidity thresholds” in consultation with dealers that would correspond to a defined delay in data dissemination. This analysis should also take into account retail participation in these less liquid securities. If it can be demonstrated that certain bonds trade infrequently or that retail participation is low, these bonds should be excluded from the transparency regime.
3. Disseminating post-trade information for all trades in Designated Corporate Debt Securities and just retail trades for all other securities. Institutional trades in non-designated bonds would be excluded from scope of the Proposal to help facilitate large trades in less frequently traded securities.

Furthermore, while the Notice acknowledges that T+1 dissemination cannot be achieved under the current MTRS 2.0 framework, we also question the feasibility of T+2 dissemination. IIROC Rule 2800C requires dealers to report their trades into MTRS 2.0 by 2pm on T+1. There will be considerable effort required by IIROC to take in the large volume of data, run validation and re-purpose the information for public dissemination by T+2. We are concerned this extremely short window afforded to IIROC considerably increases the risk of inaccurate or incomplete data getting publicly disseminated.

The CSA should also keep in mind that MTRS 2.0 was not originally designed for serving a public transparency function. There will be considerable work required by IIROC as Information Processor to take in the MTRS 2.0 data and turn it around to meet the requirements of the Proposal. For example, while the dealer specifications for MTRS 2.0 require dealers to report trade details by CUSIP or ISIN, IIROC would, in turn, need to determine the full list of CUSIPs or ISINs to comprise the universe of corporate bonds for public dissemination. This may appear to be a simple mapping exercise but given our experience this can be a complicated and time consuming task.

The Notice also states the CSA’s intention to reduce the dissemination delay over time. This decision raises important technical and market concerns that need careful consideration and discussion with market participants. First, the MTRS system could release data earlier than T+2 only if the information is provided by dealers earlier than what is currently prescribed under IIROC Rule 2800C. This would require

substantial adjustment in technology, both at the MTRS system and the internal reporting systems of individual dealers, adding substantially to data reporting costs. Second, a decision to reduce dissemination delay from agreed upon thresholds potentially increases market exposure of dealer positions and can result in a pull-back in market making. The regulators must engage in full consultation with market participants and justify a decision to reduce dissemination delay, before embarking on such a move.

Data Fields

The Proposal lists several data fields that will be made publicly available to facilitate more informed decision-making for investors. One of the data fields relates to whether the trade was an inter-dealer trade or whether it was a client purchase or sale. It is unclear from the Notice whether it is the CSA's intentions that all individual client trades to be displayed with a corresponding "purchase" or "sale" field. The IIAC is of the view that the client side of the trade should not be displayed as it could jeopardize client anonymity.

We also question the need to differentiate for public transparency purposes between inter-dealer and client trades as this could reveal participants positioning in the market. For dealers this could, for example, impair their ability to facilitate large trades for their customers. We recommend that trades only be distinguished as "institutional" or "retail" as this would be of most value for investor decision-making purposes.

New Issue Trades

The Proposal indicates that as part of phase II of the initiative, IIROC will disseminate information for all trades in new issues of corporate debt. We are unclear if this means IIROC will be disseminating information surrounding dealers' new issue trade allocations. If so, this would expand the scope of Canada's transparency framework beyond secondary market trading to include transactions in the primary market. We are unaware of any other debt market transparency framework that publicly disseminates such information and are confused on how the publication of such information would "facilitate more informed decision-making for investors".

Exempt Market Dealers

The IIAC is pleased that the CSA is reviewing whether it is appropriate to require exempt market dealers (EMDs) to report fixed income trade information to IIROC so that IIROC can establish a comprehensive source of information that would include all relevant market participants. The IIAC believes that if EMDs engage in secondary trading in debt securities they should participate in MTRS and be subject to the Proposal. Should EMDs be exempt from providing transparency on their debt market activity, it creates an un-level playing field between EMDs and IIROC dealers with some client activity potentially migrating away from IIROC registrants to the cover provided by EMDs. Requiring EMDs to report their fixed income trade information to IIROC would result in fair regulatory treatment among registrants and ensure regulators have increased visibility on EMD activities to determine whether further regulatory oversight is warranted.

Additionally, the CSA should foster a principle of “responsible market transparency” by establishing some level of oversight on how market participants generally are utilizing the increased level of transparency provided by the Proposal. A potential unintended consequence of the Proposal is that increased visibility of market transactions could result in participant behavior that is detrimental to the market. While IIROC dealers must adhere to comprehensive regulations and codes of conduct governing their activities, this same high standard is not applied across other classes of market participants.

Funding Model and Commercialization of Data

The Notice is silent on how IIROC or the CSA plan to fund the development and ongoing maintenance of the new transparency framework. While the transparency framework will significantly leverage MTRS 2.0, the IIAC believes that costs related to the design and implementation of the transparency system be funded separately from that of MTRS 2.0. Specifically, we do not believe the development or on-going maintenance of the new transparency system should be paid for by the dealers.

We are also very concerned that the Notice fails to address the property rights of the dealer as it relates to their own trading information and the value of such trading information. Specifically, the Proposal will result in a tremendous amount of valuable trade information coming into IIROC’s possession for public dissemination. The IIAC expects there to be strong commercial interest in this data which may prompt various third-parties to contact IIROC for data re-distribution opportunities. The commercialization of the data prompts several considerations including whether this advantages certain investors over others and what measures are in place to ensure that there is no breach of confidentiality of a dealer’s trading information transmitted to third parties. The IIAC has also previously commented to IIROC that the debt securities transaction data it collects rightfully belongs to the contributors of the data². The contributors, therefore, should have certain say around any future commercialization of the data. Should IIROC or the CSA consider commercializing trade data they must first arrange discussions with the data contributors. Furthermore, we would also expect that any public web portal created to display the trade information as part of the new transparency framework contain safeguards preventing unauthorized scraping of the data.

Thank you for providing us with this opportunity to comment. We would be pleased to provide further clarifications on any part of our response or bring a delegation of IIAC members to meet with CSA staff.

Sincerely,

“Jack Rando”

Jack Rando
Managing Director
Investment Industry Association of Canada

² See IIAC Submission to IIROC dated May 21 2013 <http://iiac.ca/wp-content/uploads/IIAC-Response-to-IIROC-debt-securities-transaction-reporting-proposal.pdf>