

From the Desk of Ian Russell

President and CEO, Investment Industry Association of Canada (IIAC)

IIAC Fixed Income Market Regulatory Update

Domestic and Foreign Regulatory Developments and Implications for Canadian Markets

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Canada

Regulators looking to enhance government bond transparency

- The Investment Industry Regulatory Organization of Canada (IIROC) has been designated as Information Processor for corporate debt securities. Currently, **there are no transparency requirements for government debt securities**. An exemption from transparency requirements is in place until January 1, 2018.
- The pre- and post-trade government debt data that CanPX (i.e. the previous Information Processor) received and disseminated was **provided to CanPX on a voluntary basis** by the inter-dealer bond brokers and marketplaces. CanPX's decision to end its operations, including the government debt reporting, was outside regulatory purview.
- Some market participants expressed concern that the termination of CanPX would reduce the current level of trade transparency for the government markets.
- On August 30, 2016, CanPX notified subscribers that it would continue operating a Government Bond Transparency Service.
- At the recent (i.e. September 13, 2016) Bloomberg Canadian Fixed Income Conference in New York, Victoria Pinnington, Senior Vice-President, Market Regulation, at **IIROC indicated that regulators will begin discussions on the best approach to enhance transparency and pricing in government bonds**.
- Discussions will take place between IIROC, the Bank of Canada and the Canadian Securities Administrators (CSA).

The Canadian Securities Administrators (CSA) issues guidance as to the scope of the International Dealer exemption in relation to foreign-currency fixed income offerings by Canadian issuers

- The CSA decision under National Instrument 31-103 **prevented foreign dealers from concurrently holding registration as International Dealer and Exempt Market Dealer (EMD)**.
- **Most foreign dealers opted to relinquish their EMD registration**. This meant that foreign dealers under the International Dealer registration are no longer permitted to engage in secondary market trading activities in foreign bonds for Canadian investors, including

Canadian bonds that were initially offered primarily outside Canada by foreign dealers. This **restriction limits Canadian buy-side firms' access to U.S. debt securities.**

- In a [letter](#), the Canadian Bond Investors' Association (CBIA)—which represents 48 of the largest fixed income institutional investor organizations in Canada—alerted Canadian regulators to the problem arising from regulatory action.
- On September 1, 2016, the CSA issued [guidance](#) to clarify the scope of the international dealer exemption in relation to trades in foreign currency-denominated fixed income securities of Canadian issuers and to outline the circumstances in which the CSA would be prepared to recommend exemptive relief, if required, to facilitate greater access to global fixed income markets by Canadian issuers and Canadian institutional investors.
- The CSA acknowledged that at the time of resale of a debt security, it is difficult to determine whether the debt security was originally offered as part of an offering that was made primarily in a foreign jurisdiction and whether a prospectus was filed in Canada in connection with such offering.

United States

U.S. Senators introduce bipartisan legislation to allow high quality municipal debt to be classified at a level equivalent to debt issued by corporations

- One of the key reforms of Basel III, the Liquidity Coverage Ratio (LCR), requires banks to hold an adequate amount of unencumbered High Quality Liquid Assets (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.
- **U.S. municipal bonds were excluded from the definition of HQLA** in the final LCR, while certain foreign sovereign bonds were included. There has been a push in the U.S. to classify U.S. municipal bonds as HQLA.
- On April 1, 2016, the **U.S. Federal Reserve permitted banks to count investment-grade and municipal bonds, including certain small issuances, as HQLAs**, up to a certain level if the securities meet the same criteria as corporate bonds. Insured bonds can also qualify as long as they meet criteria that apply to municipal bonds without insurance. **The final rule applies only to institutions supervised by the Federal Reserve**, i.e. bank holding companies, certain savings and loan holding companies, and state member banks.
- **The two other bank regulators—the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corp. (FDIC)—still do not allow the institutions they regulate to count municipal bonds toward their liquidity buffers.** The OCC regulates and supervises national banks and federal savings associations as well as federal branches and agencies of foreign banks, while the FDIC is the primary federal supervisor for state-chartered banks and savings institutions that are not members of the Federal Reserve System.
- On September 27, 2016, **bi-partisan legislation** was introduced in the U.S. Senate to amend the *Federal Deposit Insurance Act* to define certain municipal bonds as HQLA for purposes of the LRC.
- The bill was applauded by state and local governments because it will facilitate municipal bond issuance required to fund basic operations and infrastructure at the local level.

Securities and Exchange Commission (SEC) proposes rule change to facilitate a shorter 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.
- **On September 28, 2016, the U.S. SEC proposed a [rule change](#) to provide the regulatory certainty necessary to move to a two-day (T+2) settlement cycle** (from the current three-day settlement cycle) by September 5, 2017.
- Interested individuals have 60 days to provide comments to the SEC on its proposal.
- The U.S. financial industry applauded the SEC announcement in a [news release](#).
- **Canada has committed to shortening the securities settlement cycle from the current three days to two days to align with the U.S.**
- On July 28, 2016, the Investment Industry Regulatory Organization of Canada (IIROC) [published](#) for comment proposed amendments regarding the Canadian investment industry's move to T+2 settlement cycle. Comments are due by October 26, 2016. IIROC stated:
 - “We believe that the Amendments will have no material impact in terms of capital market structure, competition generally, cost of compliance and conformity with other rules.
 - The Amendments do not permit unfair discrimination among customers, issuers, brokers, dealers, members or others.
 - However, there will be technological implications for Dealer Members as a result of the Amendments.”

Europe

Addressing the scandals in the Fixed Income, Currency and Commodities (FICC) markets

- The Fair and Effective Markets Review ([FEMR](#)) was launched in June 2014 by the Bank of England, HM Treasury and Financial Conduct Authority (FCA) to conduct a comprehensive and forward looking assessment on the way the wholesale FICC markets operate in the wake of a number of scandals (e.g. Libor fixing) in both the UK and global financial markets.
- The outcome of the Fair and Effective Market Review was to establish the FICC Markets Standards Board ([FMSB](#)) to develop standards of conduct to improve the quality, clarity and marketwide understanding of wholesale FICC trading practices.
- The FMSB has created a non-profit corporation funded by 36 member financial institutions (25 sell-side and 11 buy-side firms) and with a small full-time staff. The FMSB established six standing sub-committees, fixed income rates products, fixed income spread products, currencies, commodities, conduct and ethics, and codes and standards convergence (to address practices and standards across industry associations and regulators to avoid duplication).
- So far, **the FMSB has published, for comment, transparency draft statements on ‘[Reference Price Transactions in Fixed Income Rates Markets](#)’ and ‘[Binary Options in Commodities Markets](#)’**. The FMSB also provided input to the work being undertaken to create a Global FX Code for currency dealing.
- The FMSB will reach out to individual foreign jurisdictions to explain the evolution and importance of the standards, and will work with the Financial Stability Board (FSB) and the

International Organization of Securities Commissions (IOSCO)—the global standard setter for securities markets regulation—to promote an international version of the standards.

- **The IIAC will review the newly developed FICC market standards, monitor ongoing progress on development and implementation, and consider the implications for Canada.**

Asia

The People’s Bank of China (PBOC) and China Securities Regulatory Commission (CSRC) have agreed on joint regulation of bond market

- **The PBOC and the CSRC agreed on joint regulation, whereby CSRC inspectors would be invited to help the PBOC oversee bond issuance, information disclosures and the transactions of bonds in the interbank market.** The PBOC and the CSRC will work together to instil discipline in the bond market, and target and punish issuers, traders or intermediaries who breach ethics.
- China’s bond market is currently overseen by three separate bodies—the PBOC, the CSRC and the National Development and Reform Commission (NDRC)— requiring debt issuers to obtain separate approvals.
- The joint regulation will commence once an approval is given by the State Council.
- **Discussions are ongoing in China to create a cross-functional financial regulatory regime in China—a so-called ‘super regulator’—that will oversee banking, securities and insurance.**

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.

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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