FIXED INCOME MARKET REGULATORY UPDATE

April 2018

Key regulatory and policy developments shaping industry supervisory, operational and business practices

Canada

CSA Proposes Derivatives Registration Rule

On April 19, 2018, the Canadian Securities Administrators (CSA) published for comment a proposed rule to establish a registration regime for dealers and advisors that transact in the over-the-counter (OTC) derivatives markets in Canada. The CSA believes the proposed registration rule, coupled with business conduct rules that were proposed in April 2017, would establish a comprehensive investor protection regime for OTC derivatives markets that would be in line with evolving post-crisis international standards. A revised version of the business conduct rules is expected to be published for a second comment period so both sets of rules can be considered together.

The proposed rule establishes registration obligations, includes requirements designed to mitigate firms' risks and aims to ensure the proficiency of certain employees of derivatives dealers and advisors. The proposed rule includes certain exemptions for investment dealers as long as they comply with equivalent requirements imposed by the Investment Industry Regulatory Organization of Canada (IIROC). The comment period for the proposed rule expires on September 17, 2018.

United States

Pilot Program to Delay Dissemination of Certain TRACE Data

On April 9, 2018, the Securities and Exchange Commission (SEC) and its Fixed Income Market Structure Advisory Committee announced they are exploring a potential Pilot Program whereby the dissemination of certain TRACE data would be delayed. Specifically:

- Cap sizes would be increased to $10 million instead of $5 million for IG corporates and to $5 million from $1 million for high-yield debt.

- All trades above their respective cap must still be reported to TRACE no later than within 15 minutes of execution, however, they would be disseminated 48 hours after execution.
- All trades in sizes at or below their respective cap will continue to be disseminated immediately upon receipt by TRACE.
- For capped transactions, the actual trade size will be made available three months after the end of the calendar quarter in which they are reported. Presently, the actual trade sizes of capped trades are made available six months after the end of the calendar quarter in which they are reported.

The length of the Pilot Program would be one year, with an early termination mechanism linked to market quality indicators. The Pilot Program recognizes that for certain corporate debt transactions liquidity can be impaired by disseminating trade information too quickly. The Pilot Program aligns somewhat with Canada's existing transparency framework for corporate debt markets where trade details are not published until two days after execution. No decision has yet been made on whether the U.S. will proceed with the Pilot Program.

U.S. Treasury Repo Rates Introduced

On April 3, 2018, the Federal Reserve Bank of New York (New York Fed), in cooperation with the U.S. Office of Financial Research, began publishing three reference rates based on overnight repurchase agreement (repo) transactions collateralized by Treasury securities. These rates are the Secured Overnight Financing Rate (SOFR), the Broad General Collateral Rate (BGCR), and the Tri-Party General Collateral Rate (TGCR).

The SOFR was identified by the Alternative Reference Rates Committee in June 2017 as its recommended alternative to U.S. dollar LIBOR for use in certain new U.S. dollar derivatives and other financial contracts.

On March 21, 2018, the Bank of Canada (BoC) announced the creation of the Canadian Alternative Reference Rate (CARR) Working Group to identify and develop a new term risk-free Canadian dollar interest rate benchmark.

Europe

SONIA Reform Implemented

On April 23, 2018, the Bank of England announced it implemented reforms to the Sterling Overnight Index Average (SONIA) interest rate benchmark. Previously, the benchmark was based on a market for brokered deposits which has limited transaction volumes. It now captures a broader scope of overnight unsecured deposits, by including bilaterally negotiated transactions alongside brokered transactions. Volumes underlying the rate based on the new methodology now average around £50 billion daily– more than three times larger than those underlying SONIA previously.

In addition to the methodological changes, the publication time of SONIA has been moved to 9 am on the following London business day. The Bank of England has taken over responsibility for calculating and publishing SONIA and will publish an assessment of its compliance with the International Organization of Securities Commissions (IOSCO)'s Principles for Financial Benchmarks in the summer.

Changes to SONIA are of significance as the benchmark is widely used by wholesale market participants, including as the reference rate for the sterling Overnight Indexed Swap (OIS) market and as the basis of the discounting of sterling denominated liabilities.

International

IOSCO Recommendations for Corporate Debt Market Transparency

The International Organization of Securities Commissions (IOSCO) has published recommendations for improving the information on secondary corporate bond markets available to both regulators and the public. The recommendations seek to ensure that regulators have better access to information so they can perform their functions more effectively, and to enhance cross-border information sharing and understanding.

Notably, IOSCO's recommendations extend to pre-trade transparency and include the following:

- Regulatory authorities should have access, either directly or upon request, to pre-trade information where it is available, relating to corporate bonds. This might include information other than firm bids and offers, such as indications of interest.
- Regulatory authorities should consider steps to enhance the public availability of appropriate pre-trade information relating to corporate bonds, taking into account the potential impact that pre-trade transparency may have on market liquidity.

The corporate debt transparency regimes in Canada, the U.S. and elsewhere currently focus mainly on post-trade information. Whether the IOSCO recommendations influence thinking in these jurisdictions remains to be seen.

Research Corner

Greenwhich Associates: Liquidity Pressures Easing in Corporate Bond Market for Small Trades

Approximately three-quarters of the institutional investors participating in a recent study by Greenwich Associates say they have no difficulty executing corporate bond trades up to US$5 million. That compares to about one-third when compared to 2016. However, the report concludes that trades over $5 million in size continue to prove difficult for investors to execute. As such, this market segment is increasingly becoming the main focus of corporate bond solutions providers. According to Greenwhich Associates, institutional investors are not relying solely on technology to ease their trading difficulties. Many are also hoping that regulatory relief from a more markets-friendly Republican Washington will allow traditional bond dealers to rebuild bond inventories and become more active liquidity providers. They also point to exchange-traded funds (ETFs) as a new and growing source of fixed-income liquidity.