



# FIXED INCOME MARKET REGULATORY UPDATE

June 2017

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*Staying informed on recent policy and regulatory developments shaping credit markets in Canada & abroad*

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## Canada

### CSA Proposes Amendments to Prospectus Exemption Reporting

On June 8, 2017, the Canadian Securities Administrators (CSA) published for comment proposed amendments to [National Instrument 45-106 Prospectus Exemptions](#) that would result in changes to the reporting surrounding exempt distributions. The objective of the reforms is to address concerns raised by some market participants, including large fixed-income investors, that the current reporting requirements are impairing Canadian institutional access to certain foreign offerings. The CSA says the proposals are designed to streamline, and increase the flexibility of, certain issuer and underwriter obligations and are intended primarily to address the concerns of foreign dealers and Canadian institutional investors. The proposed amendments follow steps already taken by CSA staff over the past year to address similar concerns, including providing relief from certain information requirements and issuing [revised guidance](#) on preparing and filing *Reports of Exempt Distribution*. In September, 2016, the CSA provided [guidance](#) as to the scope of the International Dealer Exemption in relation to foreign-currency fixed income offerings by Canadian issuers.

### BoC Financial System Review

On June 8, 2017, the Bank of Canada (BoC) released its latest [Financial System Review](#) (FSR). The key vulnerabilities in the Canadian financial system in the judgment of BoC's Governing Council are elevated level of Canadian household indebtedness and imbalances in the Canadian housing market. The FSR also discusses two vulnerabilities related to the structure of the financial system: fragile fixed-income market liquidity and the capacity of an interconnected financial system to mitigate cyber threats.

The FSR notes that when market liquidity is fragile, an unexpected shock can cause illiquid conditions to materialize rapidly and last for an extended period, with spillovers to the broader financial system. The FSR further notes that the changing regulatory environment, and the growing role of certain market participants, such as exchange-traded funds, will affect liquidity supply and demand during periods of stress, but the net impact is unclear at this time.

### Draft "Bail-in" Regulations Published

On June 16, 2017, the Government of Canada [published](#) for comment draft regulations to implement the Bank Recapitalization (Bail-in) Regime. The Bail-In Regime sets the framework for the conversion of certain bank

instruments into regulatory capital in the unlikely event that a domestic systemically important bank (D-SIB) becomes non-viable. The regulations set out key features of the regime, including that the rules would only apply to debt and shares issued by D-SIBs that are unsecured, tradable, transferable, and have original terms to maturity of at least 400 days. Such debt is held primarily by foreign and domestic institutional (fixed-income) investors.

After comments from stakeholders have been analyzed and considered, a final version of the regulations will be published. This is currently expected to be during the fall of 2017.

Concurrently with the release of the draft Bail-In regulations, the Office of the Superintendent of Financial Institutions (OSFI) also published for public comment its draft [Total Loss Absorbing Capacity Guideline](#) which is meant to ensure that D-SIBs have sufficient loss absorbing capacity to support recapitalization.

The financial crisis demonstrated that some banks may be so important to the functioning of either their domestic economy or the global financial system that their collapse could bring unbearable costs. The bail-in regimes being adopted in multiple jurisdictions around the globe gives public authorities an additional mechanism to deal with the collapse of a large bank by preserving that bank's ability to operate, while supporting financial stability and protecting taxpayers.

## United States

### Treasury Releases Report on Core Principles of Financial Regulation

On June 12, 2017, the U.S. Department of the Treasury issued its [first report](#) to President Donald Trump examining the United States' financial regulatory system and detailing recommended reforms. Treasury Secretary Steven Mnuchin indicated that most the report's recommendations could be implemented through regulatory changes rather than legislation.

The report asserts that the cumulative effect of several bank regulations implementing Dodd-Frank may be limiting market liquidity. Among the many recommendations in the report are refinements to capital, liquidity and leverage standards. These include an expanded treatment of certain qualifying instruments as HQLA and that certain instruments be excluded from the calculation of a bank's leverage exposure, including cash on deposit with central banks, U.S. Treasuries, and initial margin for centrally cleared derivatives. Treasury also recommends narrowing the scope of the liquidity coverage ratio (LCR) to include only internationally active banks and delaying the domestic implementation of the Net Stable Funding Ratio (NSFR) and Fundamental Review of the Trading Book (FRTB) rules until they can be appropriately calibrated and assessed.

Treasury also recommends significant changes to the Volcker Rule such as exempting from the rule smaller institutions whose failure would not pose risks to financial stability. Treasury also recommends further clarity surrounding Volker's prohibitions (including simplifying the definition of 'proprietary trading'), reducing unnecessary compliance burdens associated with Volker and avenues to promote market making activities.

As a next step, Treasury and the Administration will begin working with Congress, independent regulators, the financial industry, and trade groups to implement the recommendations advocated in the report through changes to statutes, regulations and supervisory guidance.

### Bill to Overhaul Dodd-Frank Clears House

On June 8, 2017, the U.S. House of Representatives passed the [Financial CHOICE Act](#), which would, among other things, repeal and replace the Dodd-Frank Act. The Act addresses areas including taxpayer-funded bailouts of large

financial institutions; penalties on those who commit financial fraud and insider trading; greater accountability from Washington regulators, and regulatory relief for well-capitalized banks. However, it is widely anticipated that Democrats will prevent approval of the CHOICE Act in the Senate, where they have enough members to block legislation.

## Treasury Repo Rate Selected as Preferred Alternate to LIBOR

On June 22, 2017, the Alternative Reference Rates Committee (ARRC) identified a [broad Treasuries repo financing rate](#) as the rate best suited for use in certain new U.S. dollar derivatives and other financial contracts. The Federal Reserve Bank of New York has proposed publishing the rate in cooperation with the Office of Financial Research. The ARRC was created to identify a set of alternative reference interest rates that are more firmly based on transactions from a robust underlying market and that comply with emerging standards such as the IOSCO *Principles for Financial Benchmarks*. The Committee's next task is to consult with market participants to develop a transition plan and evaluate implementation options for its recommended rate. Transitioning to the repo rate, especially in the derivatives market, will require broad acceptance by market participants and will likely require a considerable phase-in period.

## MSRB announces strategic goals

The Municipal Securities Rulemaking Board (MSRB) identified [strategic goals](#) that will guide the organization for the next several years and emphasize the importance of data, information and education in effective regulation of the municipal securities market. The MSRB is emphasizing supplying market participants with the resources to comply with regulations; expanding the utility of its Electronic Municipal Market Access website to provide widespread access to municipal market data and tools that support fair transactions and facilitate decision-making; and maximizing the use of data to support market transparency and regulation. Additionally, the MSRB will conduct a comprehensive analysis of relevant market data to maximize its availability, utility and quality for the benefit of all market stakeholders and the public

# Europe

## ESMA Framework for Mandatory Benchmark Contributions

European regulations provide that in certain circumstances a competent authority can require a supervised entity to contribute input data to a critical benchmark. On June 2, 2017, the European Securities and Markets Authority (ESMA) published a framework to assist competent authorities in their selection of supervised entities to be required to contribute input data to critical benchmarks. The selection of the supervised entities is made based on the size of a supervised entity's actual and potential participation in the market that the benchmark intends to measure and the framework sets out criteria how to measure it. At this stage, ESMA has developed this framework with reference only to Interbank Offered Rates benchmarks (or "IBORs") and the Euro OverNight Index Average ("EONIA"). Where applicable, competent authorities of administrators of IBORs might use this framework to select the supervised entities to be required to contribute to a critical benchmark.

## MiFID II Implementation

In a [speech](#) delivered June 7, 2017, Steven Maijoor, Chair of the European Securities and Markets Authority (ESMA), stated there will be no further delays to the introduction of Europe's revised Markets in Financial Instruments Directive (MiFID II). Maijoor says ESMA will produce further clarification in the coming weeks on certain areas of MiFID such as on the trading of derivatives, but this will not affect the implementation date scheduled for January 3, 2018. Maijoor says ESMA is undertaking a broad range of activity aimed at supporting

market participants in their preparation for implementation. This has included work on providing Q&As across a broad range of issues related to transparency requirements, commodity derivatives, data reporting and market structures topics. Additionally, Maijor points to the [opinions](#) published by ESMA on transparency and position limit regimes for instruments traded on non-EU trading venues, providing clarity for users regarding which transactions executed on non-EU trading venues will be subject to the post-trade transparency rules and whether positions held in contracts traded on non-EU venues will be subject to the position limits regime. More specifically, the ESMA opinion clarifies that, where non-EU trading venues meet a set of objective criteria, EU market participants concluding transactions on these trading venues do not have to make those transactions public in the EU under MiFIR.

## EC Releases Proposals on Supervision of CCPs

On June 13, 2017, the European Commission released [proposals](#) for more robust supervision of central counterparties (CCPs) while ensuring closer cooperation between supervisory authorities and central banks responsible for EU currencies. To achieve this, a newly-created supervisory mechanism will be established within the European Securities and Markets Authority (ESMA) called the CCP Executive Session, which will be responsible for ensuring a more coherent and consistent supervision of EU CCPs as well more robust supervision of CCPs in non-EU countries, or “third countries”.

For non-EU CCPs, the proposal builds on the existing third-country provisions in EMIR and will make the process to recognize and supervise third-country CCPs more rigorous for those which are of key systemic importance for the EU. The proposal introduces a new "two-tier" system for classifying third-country CCPs. Non-systemically important CCPs will continue to be able to operate under the existing EMIR equivalence framework; however, systemically important CCPs (so-called Tier 2 CCPs) will be subject to stricter requirements. Depending on the significance of the third-country CCP's activities for the EU and Member States' financial stability, some CCPs may be viewed of such systemic importance that the requirements are deemed insufficient to mitigate the potential risks. In such instances, the Commission, upon request by ESMA and in agreement with the relevant central bank can decide that a CCP will only be able to provide services in the Union if it establishes itself in the EU.

## Asia Pacific

### Disclosure Requirements for the Issue and Listing of Green Bonds in India

The Securities and Exchange Board of India (SEBI) has published a [circular](#) on disclosure requirements for the issuance and listing of green debt securities. The circular clarifies the definition of “green debt securities” and the additional disclosures on the objectives of the debt issuance and the use of proceeds. The circular also outlines the continuing disclosure requirements and the responsibilities of issuers.

## Global

### IOSCO Releases Report on Wholesale Market Conduct

The Board of the International Organization of Securities Commissions has published the [IOSCO Task Force Report on Wholesale Market Conduct](#), which describes the tools and approaches that IOSCO members use to discourage, identify, prevent and sanction misconduct by individuals in wholesale markets. The report identifies the tools used

by market regulators to minimize misconduct risk arising from the particular characteristics of wholesale markets, such as a decentralized market structure, opacity, conflicts of interest involving market makers, size and organizational complexity of market participants, and increasing automation. The report also describes the regulatory requirements for market participants in wholesale markets, which are based upon broad expectations of their market conduct, such as honesty, integrity and competence. These expectations are consistent with existing IOSCO principles, standards and other initiatives on conduct regulation, including its Principles for Financial Benchmarks, published in July 2013.

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