ICMA
International Capital Market Association

To: The Secretariat of the International Organization of Securities Commissions (IOSCO)
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Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets

The International Capital Market Association (ICMA) welcomes IOSCO's consultation report, *Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets*, and the opportunity for ICMA's members, constituting a broad range of market participants, to provide feedback on the report's recommendations.

Should IOSCO find it helpful, ICMA would be more than happy to follow-up directly with IOSCO and the authors of the report to discuss any of the points and suggestions made in this response in more detail. As always, ICMA would also like to put itself at IOSCO's disposal to support any ongoing work by IOSCO with respect to corporate bond market functioning, liquidity, and evolution.

Kind regards,

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ICMA

The International Capital Market Association (ICMA) welcomes IOSCO's consultation report, *Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets*, and the opportunity for ICMA's members to provide feedback on the report's recommendations.

Representing a broad range of capital market interests including banks, asset managers, exchanges, central banks, law firms, and other professional advisers, ICMA's market conventions and standards have been the pillars of the international debt market for almost 50 years.[1]

This response was prepared in close consultation with ICMA's Secondary Market Practices Committee (SMPC). The SMPC is an open forum for sell-side and buy-side member firms active in the international cross-border fixed income markets, in particular the European investment grade corporate bond secondary market.[2] Through open dialogue and engagement, as well as through its subsidiary working groups and work-streams, it seeks to be the representative body of the European corporate bond secondary market: addressing practical issues directly relevant to market practitioners; standardizing market best practice; disseminating relevant market information; and promoting the best interests of an efficient and liquid market. As IOSCO will be aware, ICMA and the SMPC regularly report on the state and evolution of the European investment grade corporate bond secondary market, as well as ancillary markets such as the repo and credit derivatives markets.[3] ICMA is also actively engaged with its members with respect to the implementation and potential impacts of MiFID II/R, including its provisions for pre- and post-trade transparency.[4]

Overview of response

This response largely relates to the European investment grade corporate bond markets, and draws on member feedback with regards to the forthcoming implementation of MiFID II/R. Given that the full impacts of the MiFID II/R transparency regime are currently uncertain, and may not be fully understood until well into 2018 or beyond, this response mainly reflects the views and concerns of market participants ahead of implementation, rather than presenting empirical evidence. However, ICMA expects to be well placed to provide IOSCO with more thorough, ex-post analysis of the impacts of the MiFID II/R transparency regime on the European secondary corporate bond markets at a future date.

The focus of this response is also with particular regard to the report's recommendations on the public availability of appropriate pre-trade and post-trade information relating to corporate bond markets

[1] See: www.icmagroup.org

[2] See: www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/secondary-market-practices-committee-smpc-and-related-working-groups/icma-smpc-and-terms-of-reference/

[3] See: www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/market-liquidity/studies-and-papers/

[4] See: www.icmagroup.org/Regulatory-Policy-and-Market-Practice/Secondary-Markets/secondary-markets-regulation/mifid-ii-r/

(recommendations 5-7), and the extent to which these could have positive or negative impacts on overall market functioning and liquidity, something that is at the core of ICMA's work and mission.

Transparency, market efficiency, and best execution

While ICMA and its members fully endorse IOSCO's assertion that 'public transparency and accessibility to information are key components of robust capital markets', it is also important to recognize that transparency is not an end in itself. The public availability of market and trading information is only desirable to the extent that it improves market efficiency and enhances protection for investors and issuers. It should therefore not be assumed that transparency naturally equates to market efficiency or liquidity, or indeed, investor protection, and it needs to be recognized that in many cases transparency, or the form or calibration of transparency, can be counterproductive, and actually undermine market efficiency and liquidity.

A number of ICMA members are keen to stress that the starting point for any discussion around market transparency should be a recognition of the fiduciary responsibility of investment firms to provide 'best execution' for their clients. Best execution is not simply contingent on finding the best available price; rather it is a multivariate concept which can include timing of execution as well as market impact. For markets that are naturally illiquid, and which require market-makers as the primary source of liquidity and immediacy, public transparency with respect to certain orders (pre-trade), particularly where the size of the order is considered larger than the median trade size (so-called 'block trades'), can actually be detrimental to best execution, both in terms of price and time to execute. Similarly, public transparency in relation to executed trades (post-trade), particularly where the size of the trade or trades is also made public, can create additional risks for the liquidity provider, as well as investors. These potential adverse impacts of pre- and post-trade transparency are accentuated in an environment where market-makers have less capacity to hold positions for a period of time.

Furthermore, the extent to which pre- and post-trade transparency frameworks impact market efficiency and best execution in ancillary markets, in particular the credit derivatives and credit repo markets, will have an impact on the liquidity and functioning of the corporate bond market, which IOSCO and other regulators should consider in their overall view of market transparency calibration.[5]

ICMA stresses that efficient and liquid markets are the most important considerations for investors, and which are valued far more than transparency in itself, since inefficient markets fail to serve both investors and issuers. This should be the litmus test for the appropriate degree of transparency for any financial market. With this in mind, policies and calibrations for market transparency should also be consistent with and supportive of political objectives to develop or expand deep and effective corporate bond markets as a primary source of financing for the real economy, such as the European Union's Capital Markets Union (CMU) project.

[5] It should be noted that the MiFID II/R transparency regime does not apply to the repo market; however, it does apply to credit derivatives, including credit default swaps (single name and index) and index options, the calibrations for which have raised concerns among both sell-side and buy-side market participants.

These important concepts of market efficiency and best execution, and the extent to which transparency can support or undermine both, are explored further in this response.

Regulatory reporting (Recommendations 1-4)

ICMA and its members are fully supportive of efficient and effective regulatory reporting, particularly with respect to post-trade. Accurate, comprehensive, and relevant post-trade (and to a lesser extent pre-trade) data is not only essential from a regulatory oversight perspective, but it also allows regulatory authorities to identify and understand better market trends and dynamics, which in turn can inform policy formulation. This is particularly important for markets that are largely traded OTC (such as corporate bond markets), and where publicly available market data is not so readily available.

Furthermore, ICMA and its members would agree with IOSCO's recommendation that to facilitate cross-border understanding of corporate bond markets by regulators, a harmonized and consistent framework for reporting is critical, particularly as markets become more global. Standardized reporting frameworks are also desirable from an efficiency perspective, not least for international investment firms that operate across multiple jurisdictions, and that must comply with more than one reporting regime. This would further suggest that where established and effective reporting frameworks already exist, these should be adopted, as far as possible, by jurisdictions that are in the process of implementing their own transparency regimes. Harmonized, standardized reporting regimes, with cross-jurisdictional cooperation, would further facilitate the possibility of a single reporting requirement for cross-border transactions, creating more efficiencies for both market users and regulators.

However, ICMA would stress the importance of refining reporting frameworks to ensure that only relevant and meaningful data is required. For example, the MiFIR reporting requirements outline 65 different data fields, a significant increase from the 24 fields under MiFID. Frameworks that require large quantities of highly granular data are not only a burden, and cost, for market participants, but can create additional challenges for regulators with respect to market monitoring and oversight. This also raises important considerations around the most efficient and cost-effective ways to report, collect, and collate data (essentially, who should report and to whom), as well as the efficient storage and maintenance of the data. Overly burdensome reporting requirements, and costs, particularly for smaller firms and investors, runs the risk of adversely influencing market behaviour, such as the choice of investment or the location of transacting.

Ultimately, the requirement for data, as well as its collation and maintenance, should be proportionate with respect to what investment firms can reasonably be expected to provide and what authorities are able to process, and ultimately be commensurate with the value of the data.

Pre-trade transparency (Recommendation 5)

ICMA members express mixed views over the potential benefits of publicly available information with respect to market quotes or actionable indications of interest (IOIs). On one hand, the ability to see firm, executable quotes helps instill investor confidence in the market, rather than referencing market quotes that are at best indicative, and at worst stale. This is particularly helpful for smaller asset managers or investors who may not have as much market colour as their larger peers, or who may be more reliant on venue-based execution, rather than on market-makers.

However, the flip side is that pre-trade information could be detrimental for investors. Firstly, the systematic internaliser (SI) regime under MiFID II/R, which will provide an obligation for dealers to make their quotes publicly available (at least with respect to liquid bonds and normal market sizes), could result in a widening of bid-ask spreads, as dealers try to avoid being 'picked off' by clients or other dealers.

Even more detrimental is the potential impact of pre-trade transparency with respect to large orders (or block trades). If the market is alerted to the intention of a firm to sell or buy a larger than normal block of bonds, particularly where the underlying bond is relatively illiquid, dealers will respond by marking their prices lower or higher. This re-pricing resulting from pre-trade transparency is counterproductive to the objective of best execution. While pre-trade transparency waivers for larger orders may provide some protection for the seller or buyer, this protection could be undermined where firms choose to split the order into smaller (below the waiver threshold) lots. In this case, the market would soon be alerted to the fact that a large order is being worked, and would re-price accordingly.

With respect to MiFID II/R, many of the concerns related to pre-trade transparency should be allayed by the fact that bonds which are considered not to have a liquid market are out of scope. At least in the short-term, the calibration for determining what has a liquid market should exclude most corporate bonds (the consensus estimate is that as of January 2018 around 95% of corporate bonds will not be classified as liquid). However, the threshold for what constitutes a liquid classification is set to be systematically lowered over the first few years of implementation, subject to an assessment by ESMA on the market impacts. As the proportion of corporate bonds subject to pre-trade transparency requirements increases, the greater the potential for detrimental impacts for market liquidity, efficiency, and best execution in many of these securities. This could further be affected by the fact that liquidity in corporate bond markets tends to be episodic or credit event driven, and very short-lived (e.g. the Volkswagen emissions or United Airlines passenger assault scandals), as well as time-zone sensitive (e.g. European credit derivatives trading in Asian market hours).

ICMA therefore recommends that, in the European context, ESMA consult closely with market participants and stakeholders in its annual assessments, and that it show a high degree of sensitivity and flexibility in implementing this phase-in process. If efficient and liquid corporate bond markets are the objective, then it would seem better to take a cautious approach to introducing greater transparency, rather than an aggressive phase-in that could harm market efficiency and undermine investor confidence.

Post-trade transparency (Recommendation 6)

ICMA's members broadly support the principle of publicly available post-trade information with respect to corporate bond markets. Far more than pre-trade information, post-trade data aids both investors and market-makers in the price discovery process, as well as adding greater confidence around valuations. Furthermore, it is helpful for issuers and syndicate managers in pricing primary issuance; something which has been noted by members of ICMA's corporate issuer constituents as becoming increasingly difficult in the European market. As IOSCO notes, where transparency helps to create market confidence, this can also be instrumental in improving market liquidity.

However, members' concerns lie mainly with the amount of information that is made available, particularly with respect to trade sizes, and the timing of public dissemination (i.e. real-time as opposed to deferred). As with pre-trade transparency, the fear is information leakage around trades in less liquid securities, particularly in larger sizes, and the natural tendency for the market to react through re-pricing. If a large trade in an illiquid security is publicized too soon after transacting, this creates risks for the liquidity provider (usually a market-maker) who may not have sufficient time to trade out of the position before the market adjusts against them. Market-makers, or other liquidity providers, aware of this risk, will adjust their quote in anticipation of any subsequent market re-pricing, or may even step away from providing a firm price altogether.

Investors, aware that market-makers will re-price or retreat in the face of a large order, may elect to split their order into smaller, more digestible ticket sizes. However, once it becomes clear through the post-trade tape that a firm is potentially working a large order in multiple, smaller lots, this could again result in the market re-pricing before the order is completed.

It therefore becomes clear that the critical consideration for effective post-trade transparency lies in the calibration of potential waivers, particularly with respect to size, and the application of appropriate deferral periods. The less liquid the security, the more important it is to apply suitable deferrals (and even possible exemptions) to the data that is reported, in order to protect both liquidity providers and liquidity takers, and to ensure that the objective of best execution is not compromised.

In the context of MiFID II/R, ICMA members' primary concern is the fact that there is no standardized or harmonized post-trade deferral period across the member states. The regulation does provide for a generic post-trade reporting timeline of 'T+2' for trades that are considered large in scale, or are in securities that are considered not to have a liquid market, however, the national regulators have the discretion to apply a supplementary deferral period of up to four weeks. (They also have a degree of discretion in how and when they report trade sizes.)

The identifiable risk is that after January 2018 there will be different post-trade regimes applied across the various EEA jurisdictions with respect to illiquid bonds and large trade sizes. This is likely to fragment liquidity, with business gravitating to trading venues (and SIs) that are subject to more accommodative deferral regimes, and away from those that impose more conservative reporting requirements. This would clearly undermine overall market efficiency, and create an uneven playing field for market participants based on location and reporting jurisdiction. The strong message from ICMA's members is that there needs to be a harmonized approach to post-trade transparency across the entire EEA, and as much as possible this should reflect the actual liquidity of the underlying securities, which would suggest the maximum possible reporting deferral of four weeks for most corporate bonds, at least with respect to information related to trade size (with the possibility that price information could be made public earlier, similar to the US TRACE model).[6]

[6] Although this would not preclude all trade details being made available to the relevant regulatory authorities as soon as practicably possible.

Consolidation of data (Recommendation 7)

ICMA fully endorses IOSCO's recommendation that regulatory authorities should take steps to facilitate the consolidation of post-trade data. Given the potential importance of appropriately calibrated post-trade data in supporting market efficiency and facilitating best execution, one could even argue that such information is a 'public good'.

This raises concerns in the European context, since MiFID II/R does not provide for a single consolidated source for post-trade data, whether through a public or private body. Rather it provides for the possibility of multiple, competing, private consolidated tape providers (CTPs), who are able to source data from regulated markets, trading venues, and approved publication arrangements (APAs). While the data provided by CTPs is expected to be reasonably priced,[7] the fact that there is not a centralized, single source runs the risk of information fragmentation and the potential for an uneven playing field in favour of market participants that are better placed to aggregate multiple sources. IOSCO's recommendation is further discounted by the fact that, so far, no entity has applied to be authorized as a CTP for bonds under MiFID II/R. Although, ESMA does have the power to initiate a public procurement process to appoint a consolidated tape provider, should the European Commission conclude that the CTP provisions have failed in their objectives. However, this is unlikely to be before 2020. Some members have even suggested that the MiFID II/R CTP framework is self-defeating in terms of the objectives of the post-trade transparency regime.

However, other members have pointed out that a public entity may not be the optimal source of consolidated post-trade data and that such an entity may lack the required resources, technological capacity, and ongoing investment. Accordingly, a commercial solution (or solutions) may be more efficient. Although, where there are multiple, competing CTPs, it will be important for users to have a perspective of the market share of the reporting entity, and so the relative value of the data they are providing.

Conclusion

ICMA and its members are broadly supportive of IOSCO's recommendations with respect to regulatory reporting and public transparency in the secondary corporate bond markets, and this response attempts to outline members' views and concerns in light of these recommendations within the context of the imminent implementation of the MiFID II/R reporting and transparency regimes. The fact that MiFID II/R will not go live until January 2018 makes it difficult to evidence some of the views expressed, and there is certainly the case for a follow-up response from ICMA and other European corporate bond market stakeholders in the next 12 to 18 months, when the impacts are better understood and lessons have been learned. However, for now, this response reflects European corporate bond market participant sentiment ahead of implementation, and it should also be noted that many members are global firms

[7] The data will be made publicly available free of charge at least after 15 minutes, or in keeping with the appropriate waivers and deferrals

that have experience of other transparency regimes, such as TRACE in the US or the frameworks in the Nordic region.

In general, ICMA and its members are fully supportive of regulatory reporting for corporate bond markets, the framework for which should be as standardized and harmonized as globally as possible. However, the reporting requirements should be proportionate; not only to avoid placing unnecessary burden on market participants, but also on regulatory authorities. To the extent that there is a single, cross-jurisdictional reporting regime, this also creates efficiencies and economies of scale, while reducing operational costs and risks for both market participants and regulators.

With respect to public transparency, there are mixed views as to the usefulness of pre-trade information, although broad support for increased post-trade transparency. The critical consideration for both, however, is the calibration of the transparency models: what information is made public, and when. Failure to get this right will have the adverse effects of undermining investor protection and impairing market efficiency and liquidity. Market transparency, in principle, should be viewed as a public good. But it should not be an end in itself.

End