Friday 30 September 2016

**INTERNATIONAL ORGANISATION OF SECURITIES COMMISSIONS (IOSCO)
CONSULTATION REPORT:
EXAMINATION OF LIQUIDITY OF THE SECONDARY CORPORATE BOND MARKETS**

INTRODUCTION

The World Federation of Exchanges (WFE), the global industry association for financial market infrastructure, appreciates the opportunity to respond to IOSCO's Consultation Report on liquidity of the secondary corporate bond markets.

The WFE represents more than 200 financial market infrastructure (FMI) providers including exchanges, CCPs, and CSDs. Our members operate FMIs in both the developed and emerging markets with 36 percent located in the Asia-Pacific region, 42 percent in EMEA and 22 percent in the Americas.

The WFE works with standard setters, policy makers, regulators, and government organisations to promote the development of fair, transparent, stable and efficient markets around the world. WFE members operate orderly public markets that promote the safety and resilience of the global financial system. Approximately $26 trillion in trading annually passes through the infrastructures that WFE members safeguard, including $2.6tr worth of domestic private sector corporate bonds[1].

The WFE applauds IOSCO's proactive and considered approach to the topic and its thorough examination of the causes and effects of changes in the corporate bond market environment and structure. In markets that are increasingly global, it is right that international bodies such as IOSCO seek to connect the dots in a well thought out and pragmatic manner.

EXECUTIVE SUMMARY

There has been a great amount of discussion by market participants, commentators and authorities about liquidity within the corporate bond market. However, much of this comes from a starting point that certain regions, or alternative asset classes, should act as a model to aspire to.

Whilst there may not have been any evidence uncovered suggesting an adverse effect globally on liquidity, relative size, market structure, types of participants/investors and methods of trading vary by region. This makes comparison and/or generalisation difficult and potentially misleading. For example:

- Differences in regional reporting systems and requirements make it difficult to assess liquidity globally;

- Comparisons with other asset classes are not always helpful. Due to differences in market structure and characteristics, asset classes will not all respond to regulatory encouragement in a similar way; and

- There exists a lack of standardisation of different types of credit products, further fragmenting markets and making it difficult to generalise at a global level.

[1] As at end 2015

As such, whilst we do not have any evidence to the contrary to IOSCO's findings, we do acknowledge the significant challenges in reaching clear and consistent conclusions. We therefore welcome the transparency mandate given to SC2 to examine further the relationship between transparency and liquidity.

However, notwithstanding the challenges as set out, WFE believes the careful encouragement of a greater proportion of secondary trading of standardised products onto centralised, neutral and cleared regulated exchanges would – in broad terms – not only improve transparency (to regulators and the market), but also likely lead to additional positive benefits such as enhanced liquidity and price formation.

This in turn should provide benefits to the real economy, enabling investors to make better informed decisions, and enabling corporates a wider choice in access to capital.

GENERAL COMMENTS

The WFE and its members share IOSCO's objectives of ensuring safe, efficient and transparent markets in which users of the market can have confidence when investing, managing risk or raising capital.

Exchanges and other market infrastructure providers have played an integral part in facilitating the post-crisis G-20 mandate. Exchanges reduce systemic risk by providing a transparent, orderly and neutral venue to manage price risk - especially in volatile markets. The facilities WFE members operate have enabled regulators to have a better picture, and exert greater oversight, of financial markets.

Furthermore, they have contributed to the growth of the real economy globally, and in individual jurisdictions – including, where relevant, facilitating alternative sources of financing for corporates from the traditional banking model or via equity financing.

The WFE acknowledges that the secondary market in corporate bonds is largely traded away from regulated central limit order-book markets (predominantly either through OTC platforms, or the telephone market).

Nevertheless, the WFE is well placed to contribute to the discussion. The number and value of corporate bonds listed on WFE member exchanges is considerable, and the value traded on their secondary market facilities is not insignificant. For example, as at the end of 2015, WFE members had reported c. 46,000 domestic private sector corporate bonds listed, representing a value of $20.6tr. The value traded on WFE secondary markets was $2.6tr.

The WFE considers more on-venue trading of certain products – with appropriately calibrated levels of transparency - alongside centralised clearing and full reporting to regulators, would likely not only improve systemic risk and market oversight, but also potentially improve liquidity and provide further credible access by corporates to finance.

Below the WFE offers its perspectives on three core elements of the IOSCO review and conclusions. Further, it offers its support to IOSCO's future work and consideration of these matters.

Market Liquidity

We note IOSCO's conclusions that there is no evidence of a marked deterioration of liquidity in non-stressed times. Further, we note this appears consistent with other recent work on this issue[2]. We have no evidence to the contrary and therefore do not disagree with the findings. However, we offer the following observations:

- Whilst general corporate bond issuance has indeed increased in recent times, we also note that newly issued bonds generally only change hands frequently soon after issuance as bond holders tend to retain ownership until redemption. Greater issuance activity therefore shouldn't be taken as greater liquidity.

- We note in recent years that there has been a gradual move of secondary market bond trading organised electronic platforms – albeit many of the platforms retain the "OTC-like" RFQ model.

- We also note a lack of standardisation of different types of credit products. In other markets (for example, derivatives - including those based on interest rates, credit, commodities, etc.) the standardisation of a product typically lends itself to greater on-platform trading – which in turn often leads to greater liquidity than afforded in the bespoke OTC market.

- Greater liquidity usually results in improved price-formation. Experience from other markets suggests that greater use of technology - particularly electronic execution mechanisms - can have a positive impact on liquidity as it enables greater access from a wider pool of participants.

- However, we caution that what has proven to work in mitigating liquidity risks in other asset classes – or indeed in the same asset class in different regions - may not necessarily mean a similar trend would occur in asset classes that have more regional characteristics and market structures such as corporate bonds.

As such, we consider encouraging a greater proportion of standardised bond market secondary trading to be traded on regulated "all-to-all" trading venues such as exchanges – or dis-incentives to remain in the opaque OTC market – may in overall terms be beneficial and would likely assist – in the case of exchanges - the further provision of alternative access to finance to the real economy.

However, any push "on market" would need to be carefully managed to take into account not only the specific nuances and functioning of the corporate bond market, but also the differences between different jurisdictions taking into account all relevant factors (including trading models, types of investor and market structure).

[2] For example, the UK FCA's review (March 2016) and the US FINRA's review (December 2015).

Data Collection / Reporting

We acknowledge the problems IOSCO had in collecting its data.

In spite of a broader global push for data standardisation (for example the reporting of transactions to regulators), this remains a challenge across many sectors. Differing markets are at differing stages of development and maturity, and reporting mechanisms and transparency obligations differ across regions.

For example, whilst the US TRACE system is mature and offers a comprehensive picture of trades reported, the lack of consistent and transparent trading volume data in the EU – at least until disclosure requirements towards regulators and the market will become applicable with MiFID2 – means there remains an incomplete picture of (and therefore it is difficult to test and assess) liquidity. Better and more consistent data should act to reduce imbalanced information and as such we encourage further analysis – particularly on a regional basis - to ensure comparisons made and conclusions reached are reasonable and credible.

The WFE is a unique industry association which is able to secure market data/statistics from its members operating in different regulatory regimes across the trade life-cycle. It has a mature and experienced research function and WFE statistics database which covers more than 350 indicators and more than 40 years of data from exchanges worldwide. Further, the WFE has experience in dealing with complex markets and issues where no one metric/indicator gives a full picture.

WFE therefore stands ready to offer help and cooperate in working through these challenges and to help regulators define comparable liquidity metrics, enabling comparison of regional/national differences in corporate bond liquidity.

Further Transparency Work

The WFE applauds the IOSCO Board's decision to give Standing Committee 2 its transparency mandate. It is right that regulators continue to assess whether there have been any negative impacts of financial reforms - especially post-2008/9 crisis.

Further, we support that regulators have access to sufficient information that is timely, accurate and detailed enough for them to fulfil their mandate and the objectives of investor protection, ensuring markets are fair and efficient as well as financial stability.

The proposal to examine transparency regimes in IOSCO member-jurisdictions and the relationship between transparency and liquidity is therefore a sensible one. Whilst there are regional or national initiatives that encourage some of this, given markets are increasingly interconnected and global it makes sense for global authorities to take a prominent lead.

Whilst we believe that enforced transparency is not necessarily the driver of increased liquidity, in the majority of cases the standardisation of product lends itself to greater on-platform trading – which in turn leads to greater liquidity, transparency, price formation and ultimately confidence in a market.

CONCLUSION

The WFE and its members share IOSCO's regulatory objectives of ensuring safe, efficient and transparent markets in which users of the market can have confidence when investing, managing risk or raising capital.

We note IOSCO's conclusions that there is no evidence of marked deterioration of liquidity in non-stressed times. We have no evidence to the contrary and therefore do not disagree with the findings.

However, we appreciate the challenges of reaching this conclusion (data, and metrics) and that this is not an "exact science", with many factors at play (including the health of the economy, the interest rate environment, market structure, participant behaviour, the maturity of the market, regulatory intervention, etc.).

We consider a careful encouragement[3] of a greater proportion of secondary trading of standardised products onto centralised, neutral and regulated trading venues – such as exchanges - would likely provide benefits, including helping them to provide alternative access to finance for companies, as well as improve liquidity and price formation, because such markets are more accessible to a wider pool of participants. This in turn should provide benefits to the real economy, enabling investors to make better informed decisions, and enabling corporates a wider choice in access to capital.

Nevertheless, we also acknowledge there is a fine balance between transparency encouraging liquidity, broadening participation and reducing spreads – and compromising it (for example through fragmenting the market which would likely drive up costs and widen spreads). Further, differences in market structure mean a one-size-fits-all approach may not be suitable, and that there may be liquidity risks in adopting a "big-bang" approach.

We therefore welcome the transparency mandate to examine further the relationship between transparency and liquidity. Should regulatory authorities such as IOSCO conclude it desirable from a public policy perspective to consider initiatives to encourage a greater proportion of secondary trading in corporate bond markets into a regulated trading environment, the WFE stands ready to assist, including offering:

- Access to WFE members (i.e. primary and secondary market facilities, CCPs and CSDs);

- Access to the WFE statistics database which covers more than 350 indicators and more than 40 years of data from exchanges worldwide;

- Collaboration on future work – for example data collection, analysis, creation of new liquidity indicators/metrics; and

- Coordination of industry solutions.

[3] as long as transparency is appropriately calibrated