efama

European Fund and Asset Management Association

EFAMA reply to the IOSCO Consultation Report on regulatory reporting and public transparency in the secondary corporate bond markets

EFAMA[1] welcomes the opportunity to comment on the IOSCO Consultation Report on regulatory reporting and public transparency in the secondary corporate bond markets.

General comment.

We welcome the recognition of the efforts of EU Regulated Funds to support the economy by increasing indirect retail participation in the corporate bond market, through mutual funds and exchange-traded products. We also share the analysis made in the IOSCO Liquidity Report [2]on the fact that some dealers are decreasing their trading presence and capital allocation in certain products.

Regarding the main goals of the Consultation, we agree with IOSCO's views on the lack of consistency in standards. We consider that a standardization of the information available as well as the structure of the document provided by the issuers are key elements to meet those goals and to ensure clarity and availability.

We support the IOSCO recommendation aiming at ensuring that regulatory authorities have access to sufficiently detailed information to perform their regulatory functions also but not only in corporate bond markets. With that purpose in mind, we would insist on the fact that the required information should be focused on:

- Fulfilling the objectives pursued in a cost-efficient manner;
- Using recent reporting formats (such as ISO 200022 standards); and
- Avoiding overlaps with other existing regulatory reporting, therefore recognising equivalence of principles when implementing the Recommendations.

Lastly, we regret the absence of reference to principles of Investors' protection in the proposed recommendations. We consider that even if transparency is a key factor to protect markets stability and market liquidity, we would recommend IOSCO to also include Recommendation that would foster Investors' confidence and investors' protection. This could be achieved through more information provided in meaningful format and contain.

[1] EFAMA is the representative association for the European investment management industry. EFAMA represents through its 28 member associations and 62 corporate members close to EUR 23 trillion in assets under management of which EUR 14.9 trillion is managed by 59,588 investment funds at end Q2 2017. UCITS (Undertakings for Collective Investments in Transferable Securities) accounted for 31,294 of these funds, with the remaining 28,294 funds composed of AIFs (Alternative Investment Funds). For more information about EFAMA, please visit www.efama.org

[2] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD558.pdf.

Detailed comments

Recommendation 1
Regulatory authorities should be able to obtain the information necessary to develop a comprehensive understanding of the corporate bond market in their jurisdiction. This understanding should include the characteristics of the market and the types of bonds traded.

EFAMA agrees with the IOSCO's proposed approach.

However, we wish to insist on the need to standardise the format of the documentation to the largest possible extend.

This would:

- Allow comparability between issues;
- Facilitate cross border distribution; and
- Reduce barriers to cross country investments.

For existing securities, we would recommend to enforce an update of the format within one year after the entry into force of the Recommendations for bonds that are distributed cross-border and two years for those that are only distributed at national level.

Recommendation 2
To facilitate cross-border understanding amongst regulators of corporate bond markets, a clear framework and underlying methodology of regulatory reporting and transparency should be available.

We agree with the Recommendation 2.

We would however insist on the need to have aligned regulatory reporting formats or automatic equivalence when the Recommendations are respected.

From an asset managers' viewpoint, this is a key feature to:

- reduce cost;
- ensure the respect of best execution principles; and
- provide easily accessible and comparable information.

Recommendation 3
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.

We agree with the Recommendation 3 and would suggest some further details.

We would recommend IOSCO to ensure that rules imposing greater pre-trade transparency are also protecting market liquidity, especially for a secondary market as specific as the Corporate Bond market.

This could be achieved by taking inspiration from the work done by European policy makers in the context of MiFID II and MiFIR.

1. Definition of liquid corporate bond to apply pre-trade transparency.

We consider that pre-trade rules (especially in corporate bond markets) must be developed, assessed and imposed based on the liquidity of the related issued security.

In order to maintain the liquidity in the markets and ensure sufficient transparency, we would propose the following criteria to define the level of liquidity of a bond and the pre-trade duties applicable to it:

		corporate bonds	corporate bonds
Issue Size	transaction size	disclosure requirement	vo (eur)/trade no
Above 5bn	20 mm above	Volume omission, EOD	5Bn / 200 tr
	10-20mm	Volume omission, EOD	5Bn / 200 tr
	1-10mm	real-time	5Bn / 200 tr
	up to 1mm	real-time	5Bn / 200 tr
500mm - 1bn	Above 10 mm up	volume omission, EOD	20mm/20 tr
	5-10 mm	T+3	20mm/20 tr
	1-5 mm	T+3	20mm/20 tr
	500k-1m	T+3	20mm/20 tr
	Under 500 k	Real-time	20mm/20 tr
up to 500 mm	all trade sizes	time delay	all trade sizes

Other criteria might be added and could bring some further information but with less importance. For instance, IOSCO could use:

- Average frequency of trade in absolute numbers;
- Time period for calculation with a monthly retrospective calibration;
- Calculation of total turnover with the ADT calculated by dividing the notional volume turnover (rather than market value) by the number of days in the period on a monthly period; and / or.
- The calculation of the total number of trades based on the use of block trades rather than allocations (due to the matching process applied to bond trading).

2. Use of waivers.

We are concerned by any proposals that would propose to remove the waivers from pre-trade transparency including those provided under MiFID. These waivers provide much needed protection for institutional long term investors from the activities of short term profit takers while at the same time not impacting on the overall transparency and efficiency of the markets.

From an asset manager's perspective, we believe that MiFID II and MiFIR implementing measures demonstrate that:

- the waiver is critical to the functionality of several business models; and
- there is disagreement amongst some regulators as to what should or should not be allowed.

MiFID currently makes use of four waivers:

- Large in Scale Waiver (LSW). This is used to exempt large orders from pre-trade transparency thereby avoiding market impact;
- Reference Price Waiver (RPW). This allows trading venues to determine prices by reference to a widely published price instead of actual prices and has numerous benefits for market efficiency and ultimately end-investors as we explain below;
- Negotiated Transaction Waiver (NTW). This allows trades to be concluded off exchange (between two market participants or between a market participant and the operator of the trading venue) at a price that is in line with current market conditions; and
- Order Management System Waiver (OMSW). This allows venues to split large ("parent") orders into small ("child") orders. The small pieces are pre-trade transparent, but when the remaining size of the large order falls below large in scale, that part is also kept dark.

To fulfil best execution of large client orders, asset managers would typically seek to execute the trade across the full range of execution venues. The buy-side trader will factor in the cost of execution and more recently, the risk of interacting with the Central Limit Order flow provided by High Frequency Traders (HFT).

The MiFID waivers are often used in combination with each other since they interact to safeguard and facilitate institutional investors' ability to efficiently implement substantial investment decisions - a key element of the MiFID I regime.

MiFID waivers are the mechanisms through which execution choice is made possible:

- Increased liquidity: The possibility to use waivers brings participants into the market that would not have otherwise been there. Likewise, the removal of the waivers will not, we believe, translate to a direct shift of liquidity from 'dark' to the 'lit' markets. Instead it will segment client orders into those which can benefit from crossing and those that cannot;
- Lower costs: At present, a broker with two opposing institutional orders can automatically match the orders, or parts of them, at the same price. Without this possibility, the broker would be forced to incur spread costs on behalf of both of its clients by accessing a 'lit' order book. The buying client then pays a higher price than the selling client for no good reason; and
- Less risk of the market moving against the client's interest: Without the protection the waivers provide, the broker would force to publish orders and thus flag their clients' intent to the market.

With this information the market could move against the client, which is an unnecessary risk and avoidable cost for the end-investor.

- Helping long-term investors and financing the SME market: The reference price waiver allows asset managers to place orders to buy or sell large blocks of equities on behalf of their clients, commonly a range of funds, life pools and pension schemes. These long-term investing clients are vulnerable to the risk that other market participants will identify their need to trade in large size and move the price against them. The suppression of the reference price waiver would limit the capacity of long term investors to invest in the SME market because of important execution cost and impact finally the potential growth of the global economy.

If EFAMA's proposal were followed, we would hope that concerns that there any loss of information for the price discovery process would be insignificant compared to the benefit to the long-term investors. Additionally, as both markets and patterns of order execution are dynamic and as fulfil best execution requirements practices evolve over time, it would be appropriate therefore to review implementing standards over time.

Recommendation 4

Regulatory authorities should implement post-trade (transaction) regulatory reporting requirements for secondary market trading in corporate bonds. Taking into consideration the specifics of the market, these requirements should be calibrated in a way that a high level of reporting is achieved. These requirements should include the reporting of information about the identification of the bond, the price, the volume, the buy/sell indicator and the timing of execution.

We support IOSCO's Recommendation 4.

However we would like to highlight several important elements that would ensure an efficient level of post-trade transparency.

1. Need for unique and uniform instrument identifiers.

We agree with IOSCO that adequate identification of bonds is crucial. This requirement is critical not only for post-trade reporting but from the initiation of the issuance process of any security.

In that perspective, we urge IOSCO to issue a strong and unequivocal recommendation that fosters mandate the use of only one unique standard to identify securities, namely ISIN codes.

They have the benefit of their global usage and they are already referenced in multiple legislations.

This would allow better control of costs of issuance of corporate bonds as there would no longer be a need to pay and monitor for multiple references for the same instrument.

2. Need for the maintenance of principles of deferred publication.

We believe that principles of transparency should be set in a manner that also protect large trade on bonds, as recognised by ESMA and some Members of the European Parliament[3]. Therefore we would suggest that National Competent Regulatory Authorities should have by default the authority to defer publication at all times, and that a single regime should apply globally. Additionally, we would further suggest that volume information should be masked for a period of four weeks or until the risk-taker has exited the position, whichever is sooner.

From the perspective of an asset manager, we are of the view that

- a deferral regime limited in time would not sufficiently protect interest of end-investors.
  - If large or sensitive trades are publicly disclosed within 48 hours or even just after 48h for the largest trades, this will raise the attention of market participants over potential big remaining trades. This would inevitably lead a deterioration in the prices offered by counterparties for the orders that are yet to be executed.
  - Further, there is a risk that as a result of these disclosures the counterparty to the first part of the disclosed trade would be unwilling to continue to offer quotes for the rest of the unexecuted trade. This is due to the increased market risk they would be exposed to as other market participants would be aware of their new large or sensitive position. This would mean that asset managers will be unable to exit large bond positions due to a lack of counterparties to transact with or they will be subject to extremely conservative pricing for trades in large sizes;
  - The non-disclosure of such large executed orders would NOT harm the market activity - while helping the best execution of block orders to the benefit of our clients (being UCITS funds, AIF funds or mandates), reminding that in addition to best execution we have a fiduciary duty to act in the best interest of our clients;
  - Conversely, if disclosed too early, it would not improve significantly the market activity as such WHILE it would create a clear big issue for the execution of the remaining part of the block orders – as it would raise the attention of market participants on the regular execution of large trades on the same instrument over several consecutive days, and therefore the execution of the remaining part of the block orders might not be executed at all, or at very bad prices/timings; and
  - Ultimately, it will deteriorate the average execution price obtained for the total of the trades executed on behalf of the relevant investors, as compared to the situation where trades had not been publicly disclosed during four weeks.
- The issue of the four weeks optional exemption itself, as currently proposed by European institutions may also be insufficient. Whilst there is an optional exemption for delaying the public disclosure of the trade up to four weeks that can be allowed by the relevant NCA, the procedural aspects of this exemption is not manageable in practice. This is because:
  - The exemption must follow a request from the relevant broker which is expressed in anticipation of the trade execution. The point is that in many cases, and considering the daily uncertainty of financial markets and related unpredictable trade decisions taken by institutional investors, large trades from institutional clients cannot be anticipated in many

cases by brokers. Therefore the required ex ante request from the broker to its the National Competent Authority is not manageable in practice;
  - An order may be split with various counterparties leading to an exemption request to be sent to several NCAs. Obtaining the agreement from all the NCAs geographically involved in the trade would be complicated and lengthy.

Ultimately, it would ensure adapted transparency that would also provide best execution of large trades in the best interest of institutional and retail investors.

We are of the opinion that mechanisms of automatic deferral of publication of transaction should be allowed.

<u>Recommendation 5</u>

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.

We agree with IOSCO Recommendation 5.

We consider that it is also impossible to have sufficiently detailed and relevant pre-trade information if there is a misalignment between pre- and post-trade transparency.

In that perspective, we wish to insist on the elements raised in our comments to Recommendation 3.

Lastly, we wish to remind IOSCO that we consider that comparable information on each issues is also an important element to foster transparency.

<u>Recommendation 6</u>

Regulatory authorities should implement post-trade transparency requirements for secondary market trading in corporate bonds. Taking into consideration the specifics of the market these requirements should be calibrated in a way that a high level of post-trade transparency is achieved. They should also take into account the potential impact that post-trade transparency may have on market liquidity. Post-trade transparency requirements should include at a minimum, the disclosure of information about the identification of the bond, the price, the volume, the buy/sell indicator and the timing of execution.

We agree with Recommendation 6.

Recommendation 7
Where there is transparency of post-trade data relating to corporate bonds, regulatory authorities should take steps to facilitate the consolidation of that data.

We agree with Recommendation 7.

Nevertheless, we also consider that no sufficient effort is made to ensure the implementation of a true consolidated tape covering all instruments.

From our perspective, we are of the view that:

- A global and publicly mandated CT would be the most efficient way to guarantee transparency and avoid reconciliation issues;
- Should CT be deployed under commercial initiatives, we would recommend that:
  - There are standards of reporting and coordination of numbering (through ISIN codes and Unique Product Identifiers);
  - There are efficient and robust reconciliation mechanisms; and
- The CTs should apply on all types of financial instruments.

***

Brussels, 16 October 2017
[17-4051]