



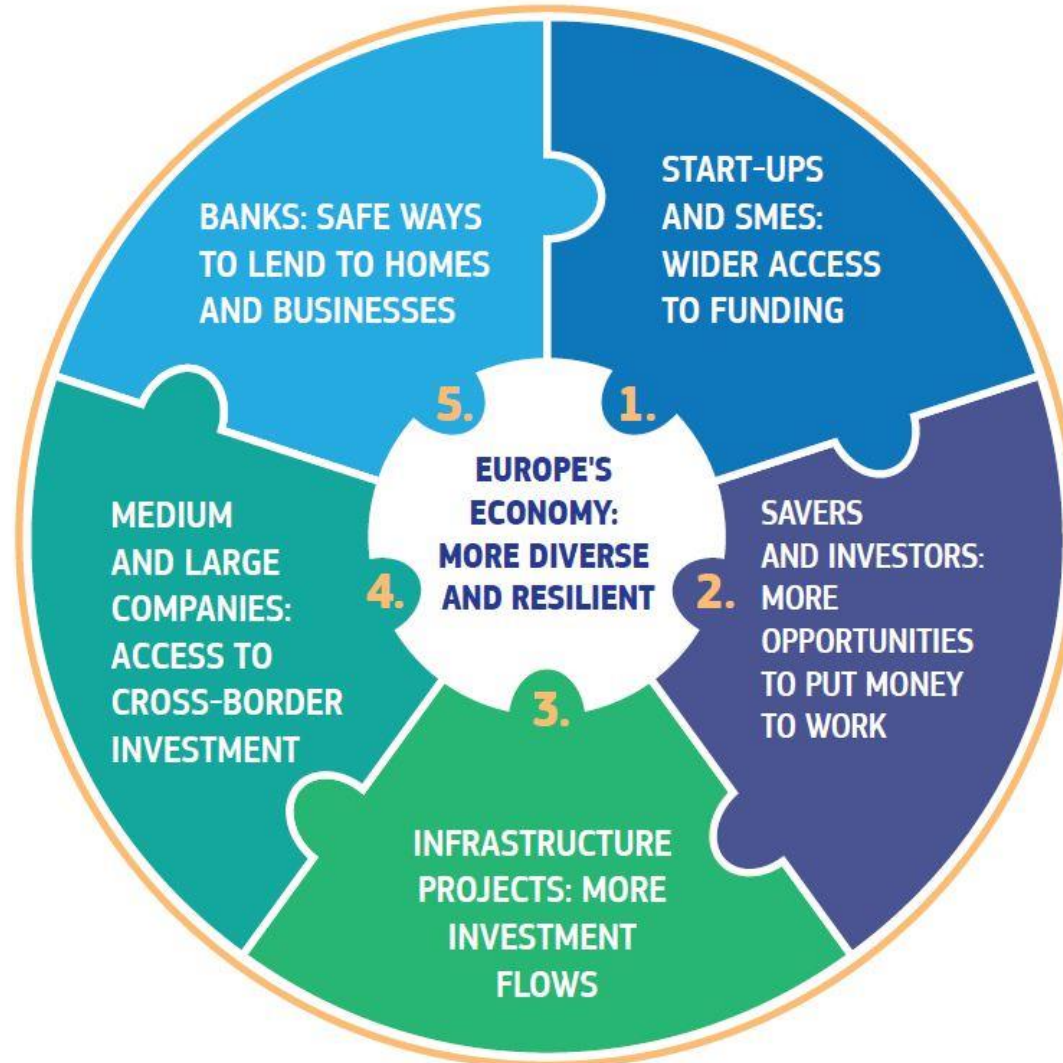
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#CMU

**Niall Bohan -
Regulatory outlook for European bond
market liquidity**

*AFME Market liquidity conference
London, 23 February 2017*

CMU = finance for investment & growth



The CMU pipeline is delivering

	<u>Policy Action</u>	<u>State of play</u>
Risk Calibration	Lower (>1/3) prudential calibrations for insurance investments in infrastructure/ELTIFs	In force since April 2016
Prospectus Directive	Proposal to streamline Public Offer Prospectus	Agreement by the co-legislators in December 2016
STS securitisation	Proposal to revive Simple, Transparent and Standardised securitisation	Agreed in record time by Council - EP vote end 2016 followed by EP-Council negotiations
Insolvency	Proposal on preventive restructuring & second chance	Adopted in November 2016
Debt-equity bias	Address debt-equity bias in national corporate tax systems	CCTB proposal adopted in November 2016
VC funds-of-funds	Establish Pan-European venture capital funds-of-funds	Call for applications of managers closed at end January 2017
EuVECA	Revise EuVECA legislation	Council general approach agreed in December 2016

Next wave of CMU priorities

	Policy Action
Personal pensions	Possible legislative proposal (2017) to underpin the development of personal pensions across the EU
Retail financial services	Action plan to open up EU market for retail financial services (expected in March 2017)
Securities law	Legislative proposal to clarify applicable law for competing claims on securities or debt assignments traded cross-border (2017)
Sustainable and green finance	Creation of an expert group to develop European strategy on how to integrate sustainable and green finance in the financial framework
FinTech	Innovative potential should be harnessed while protecting investors (crowdfunding, robo-advice)

CMU Mid-Term Review

- **COM has delivered** $> \frac{1}{2}$ of 33 initial actions, incl. most powerful ones;
- **Mid-Term Review: opportunity to take stock and build on progress so far;**
- **Input from stakeholders** is important:
 - **Consulation** ongoing until **17 March**;
 - **Public hearing** on **11 April**;
- Publish **Mid-Term Review** on **7 June**.



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European corporate bond markets

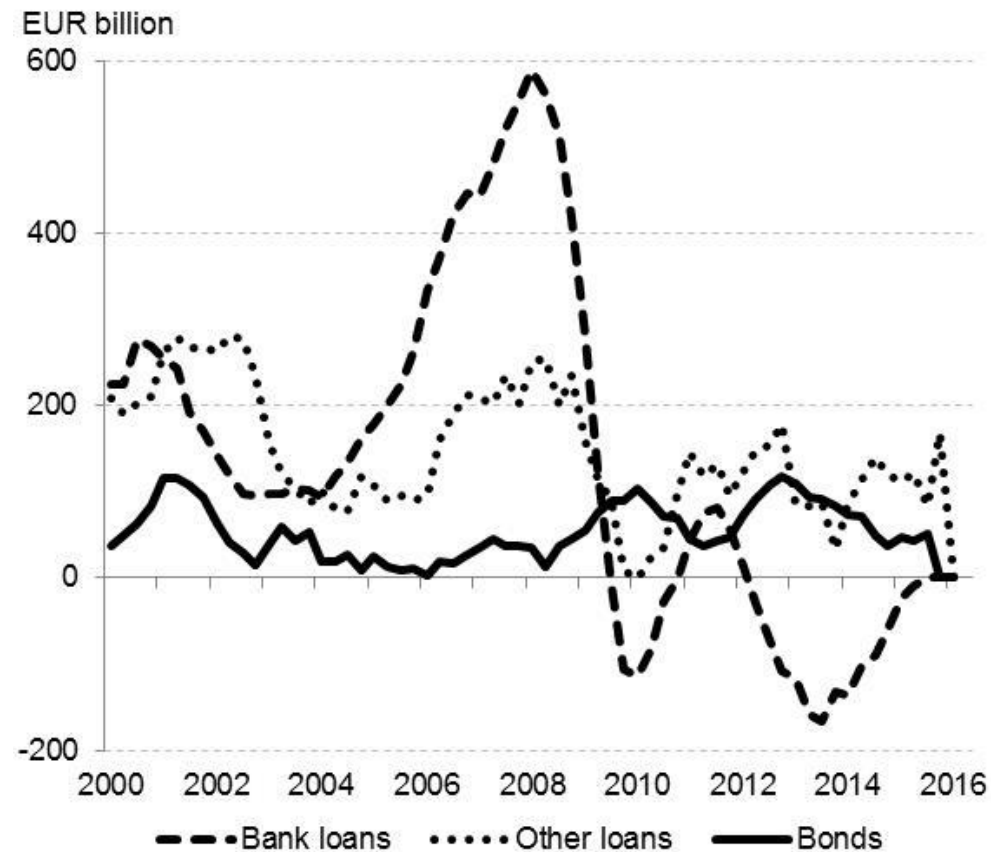


Introduction

- Improve **alternatives to bank loans** for corporates;
- **Recognise growing importance** of bond financing;
- **Support the market through enabling measures (e.g., private placement);**
- **Aware of stresses** the market is undergoing coming from different areas;
- **Key CMU action:** integrated, efficient and resilient corporate bond market;
- COM set up dedicated **Expert group.**

Reduced overreliance on bank loans

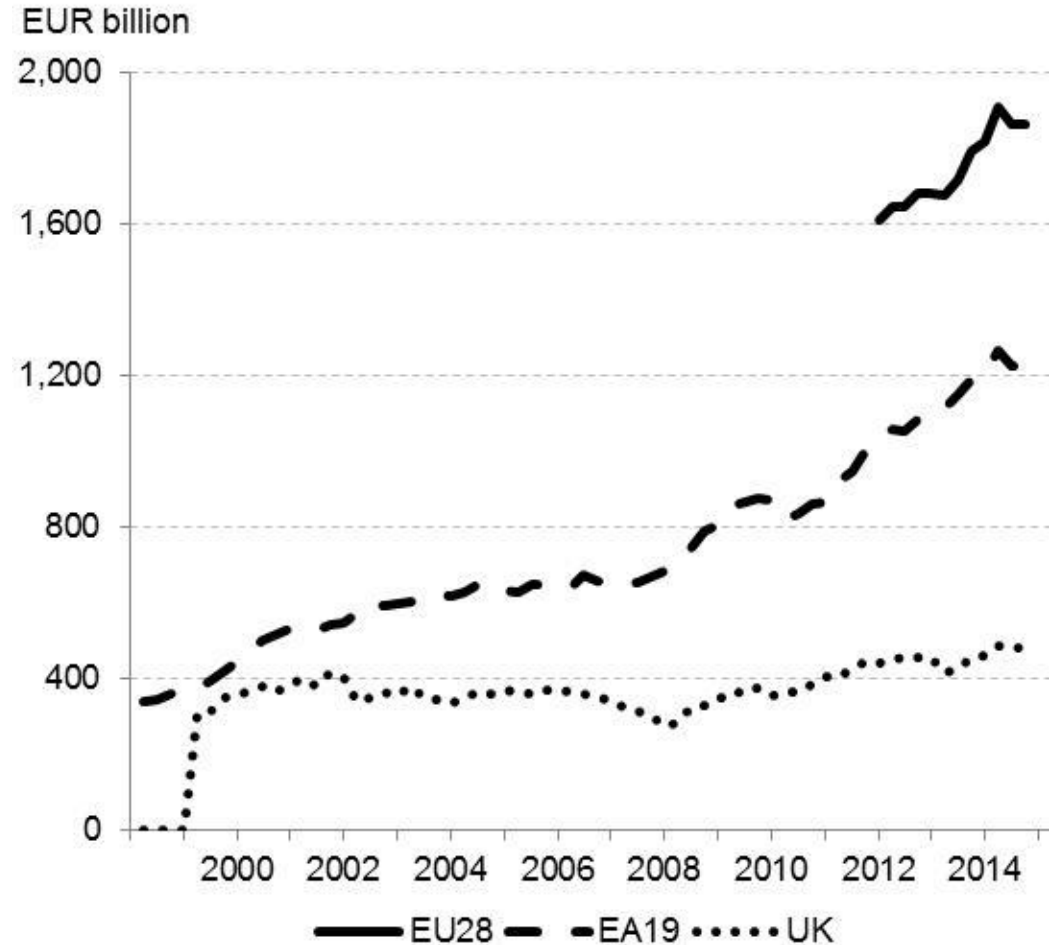
Dynamics in NFCs' sources of debt funding (liabilities) in the euro area



Source: ECB, Eurostat and own calculations.

Corporate bond issuance rose in volumes...

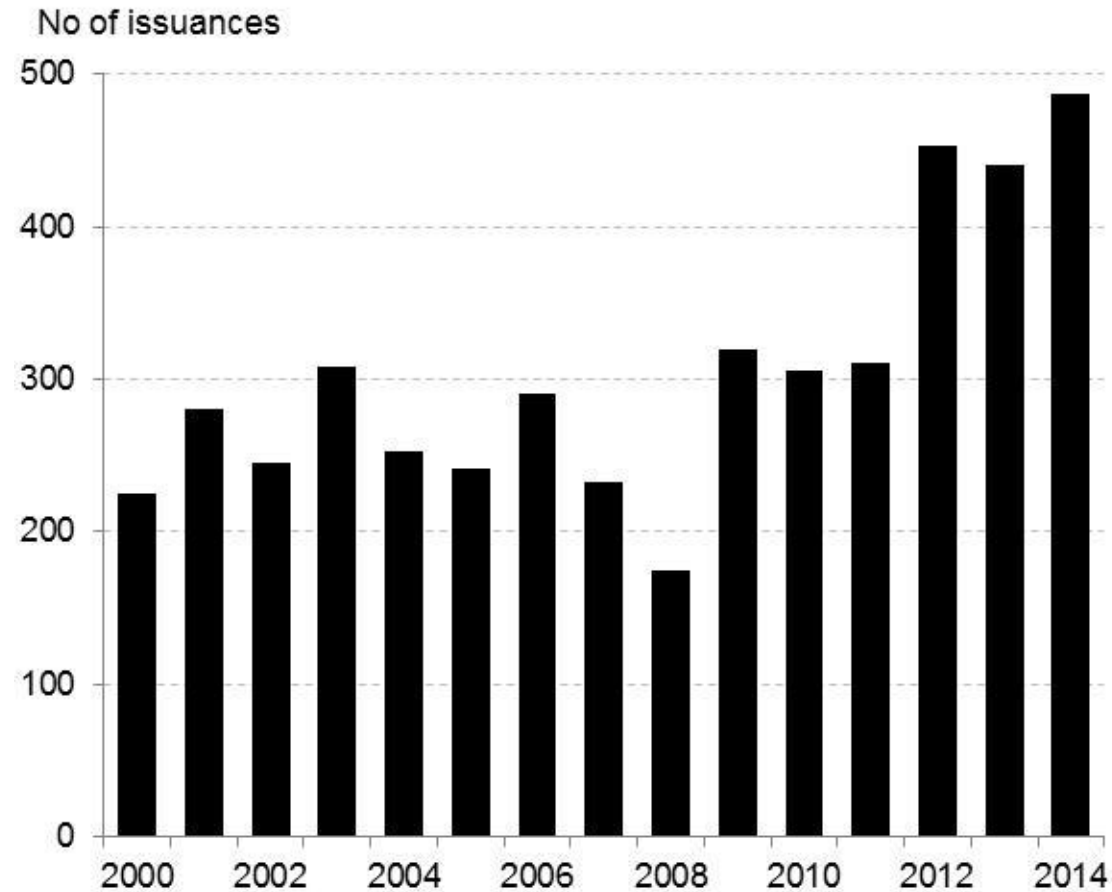
NFCs' bonds: outstanding amounts



Source: ECB, Eurostat and own calculations

... and number of issues...

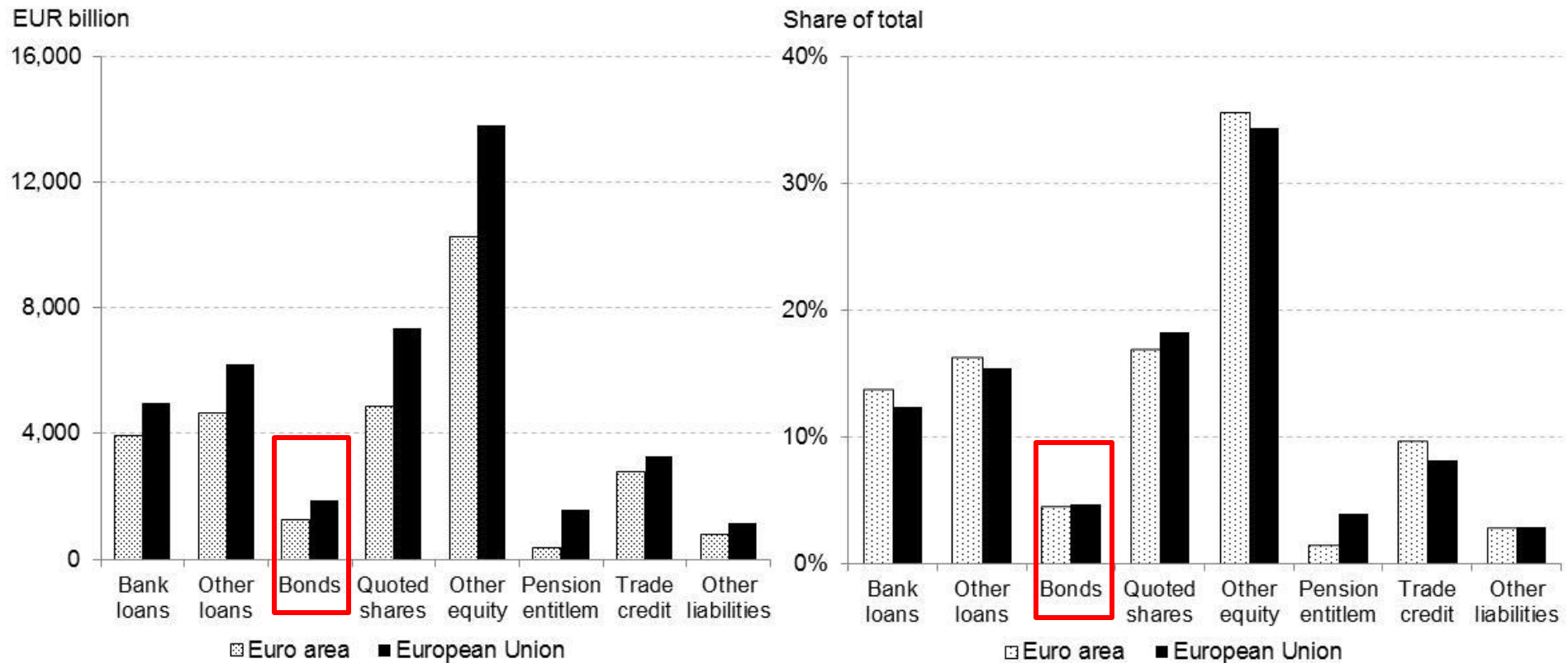
Number of bond issuances by EU NFCs



Source: OECD

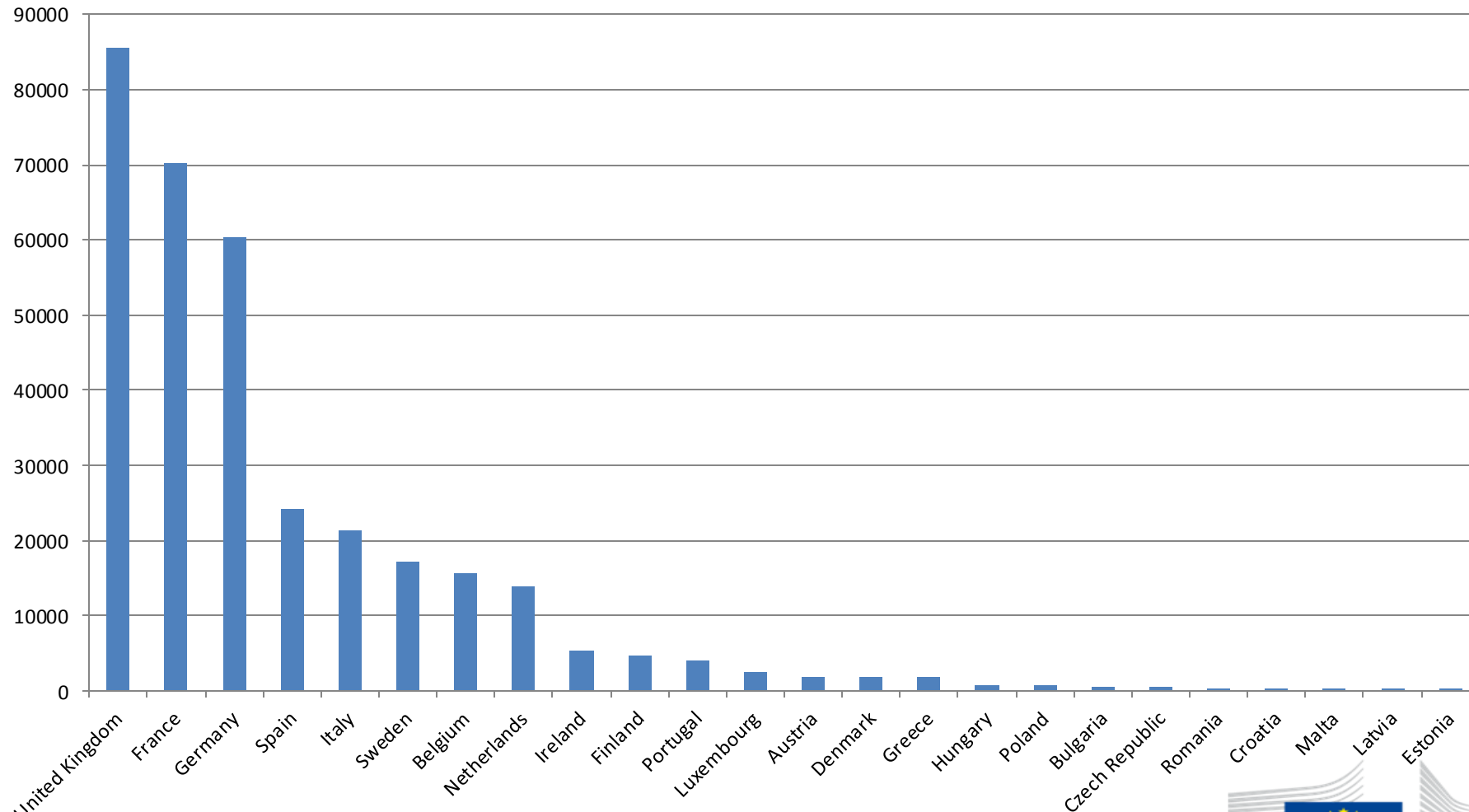
... but remains a marginal source of funding on average...

NFC's funding sources (financial liability), 2015



... and is very uneven across member states...

NFC's Deal total volume, 2016

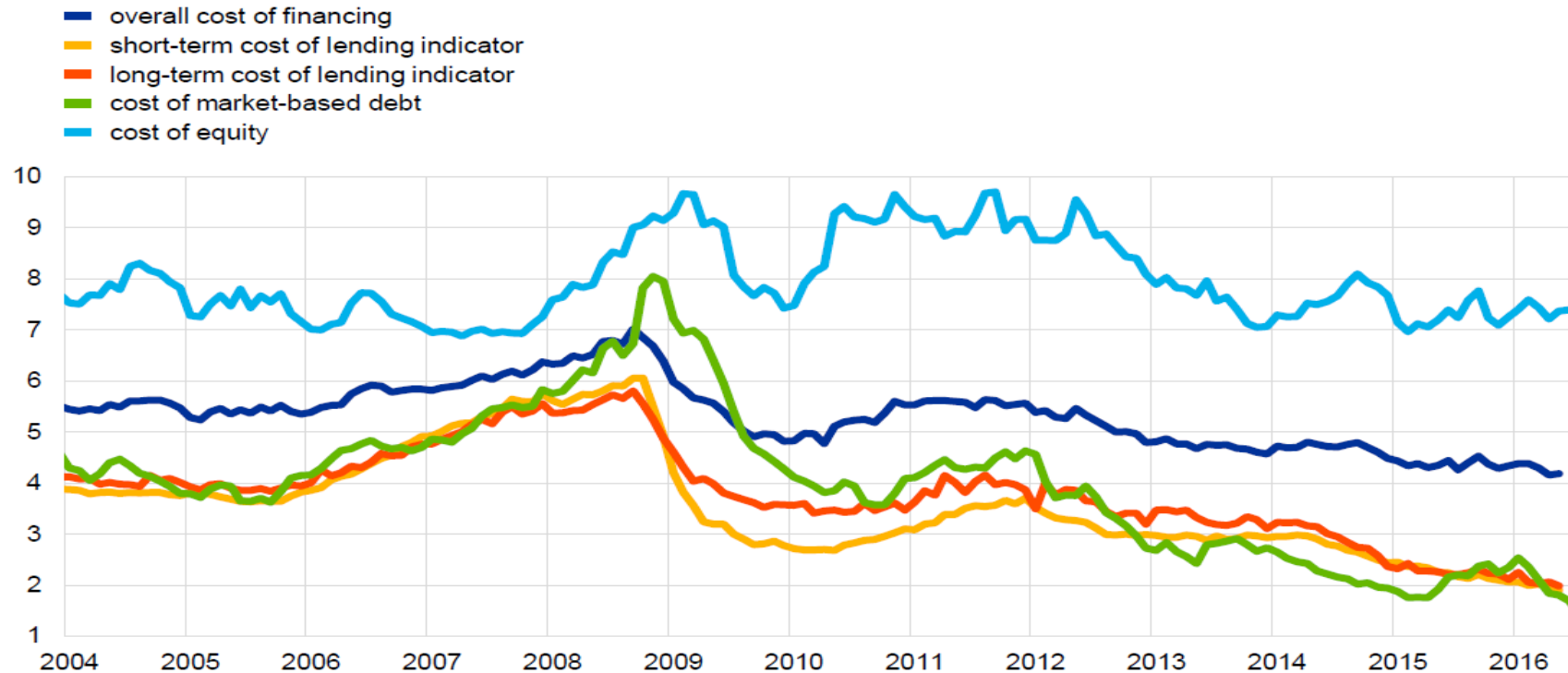


Source: Dealogic



Low cost of corporate bond financing

(percentages per annum)



Sources: Thomson Financial DataStream, Merrill Lynch, ECB, ECB calculations.

Notes: The overall cost of financing for NFCs is calculated as a weighted average of the cost of bank lending, the cost of market-based debt and the cost of equity, based on their respective amounts outstanding derived from the euro area accounts. The latest observation for overall cost and lending rates is for May 2016 and the latest observation for the cost of market-based debt and cost of quoted equity is 20 July 2016.



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Liquidity in European corporate bond markets



Studies on liquidity (public sector)

- AMF: liquidity improved after 2012, without recovering to pre-crisis levels, more concentration;
- BoE: reductions in liquidity partly reflect post-crisis regulations (beneficial for resilience);
- ESRB: mixed evidence: concern around pricing anomalies and deterioration in repo markets (end 2016)
- FCA: inventory of dealers declined, no evidence that liquidity deteriorated.

Studies on liquidity (private sector)

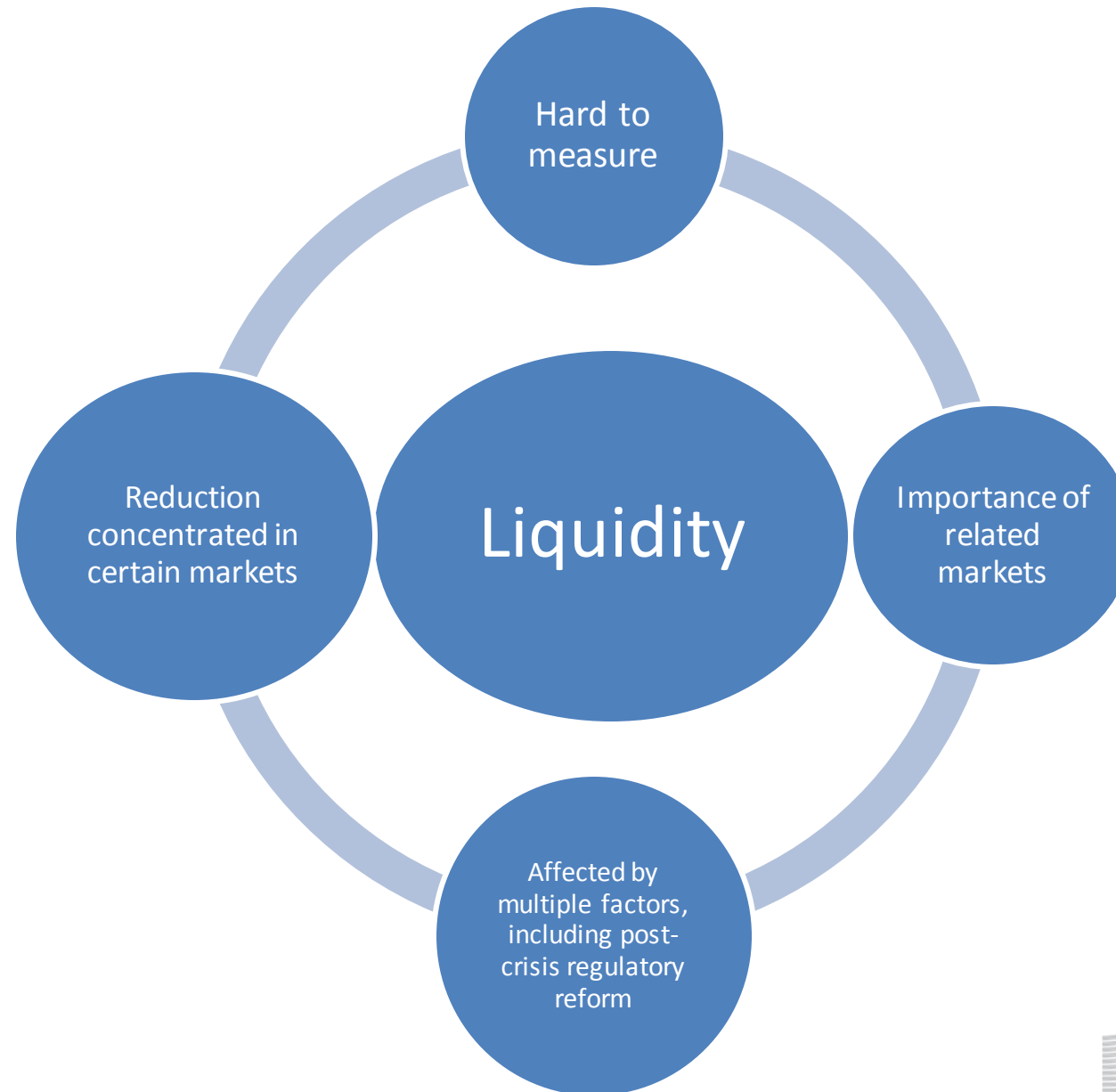
- **GFMA/PwC Global Financial Markets Liquidity Study**

- measurable reduction in liquidity;
- large trades more difficult;
- reduction in banks' trading capacity;
- decline in turnover ratio;
- reforms detrimental to liquidity

<https://www.afme.eu/en/reports/publications-and-data/publications/pwc-study-on-global-financial-markets-liquidity/>

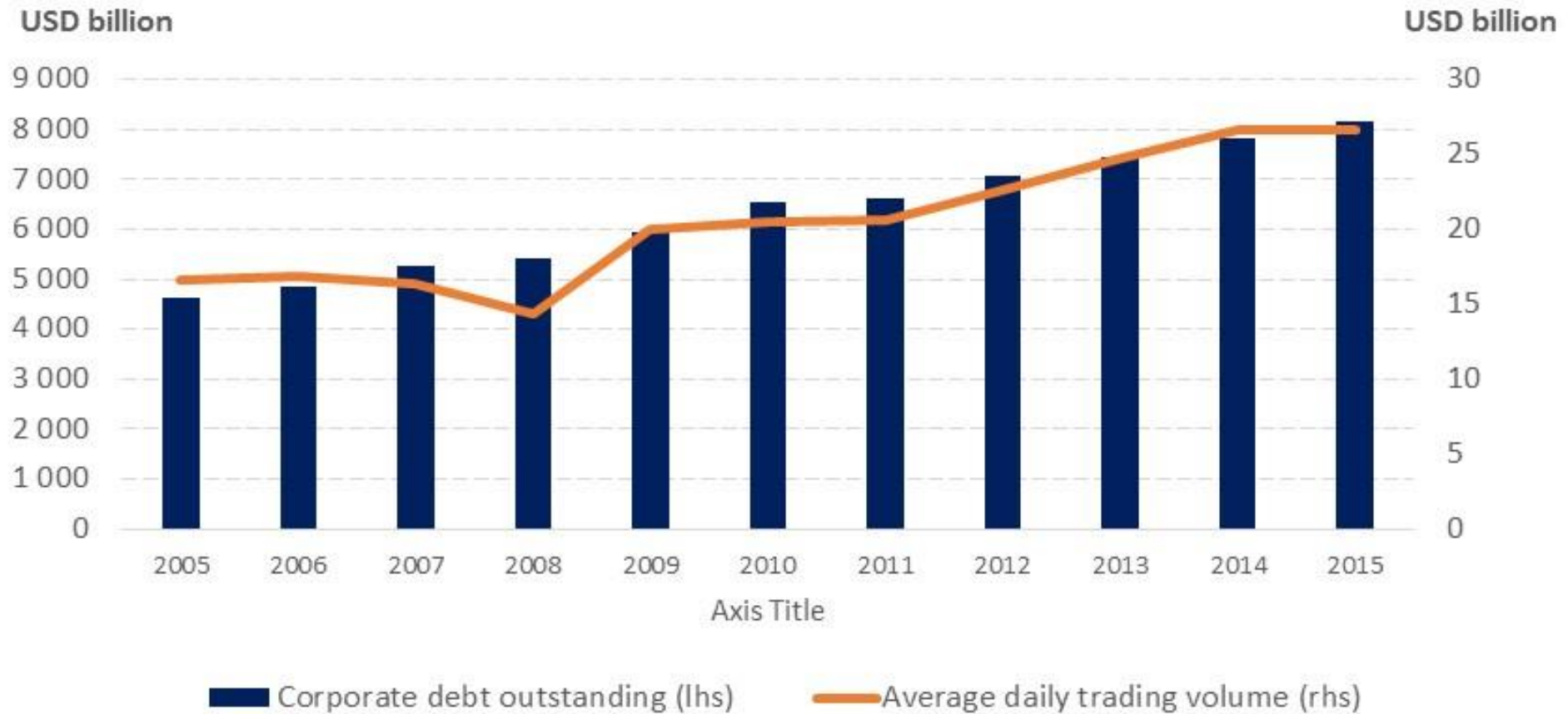
- **ICMA survey:**

- General expectation that liquidity will deteriorate further;
- QE and MiFID Transparency biggest impact;
- Recommendations: (i) capital relief, (ii) revitalise CDS market, (iii) review regulation and (iv) bring market stakeholders together to review market structure.



Corporate bond are structurally illiquid

USD corporate debt market, outstanding and average daily trading



■ Corporate debt outstanding (lhs)

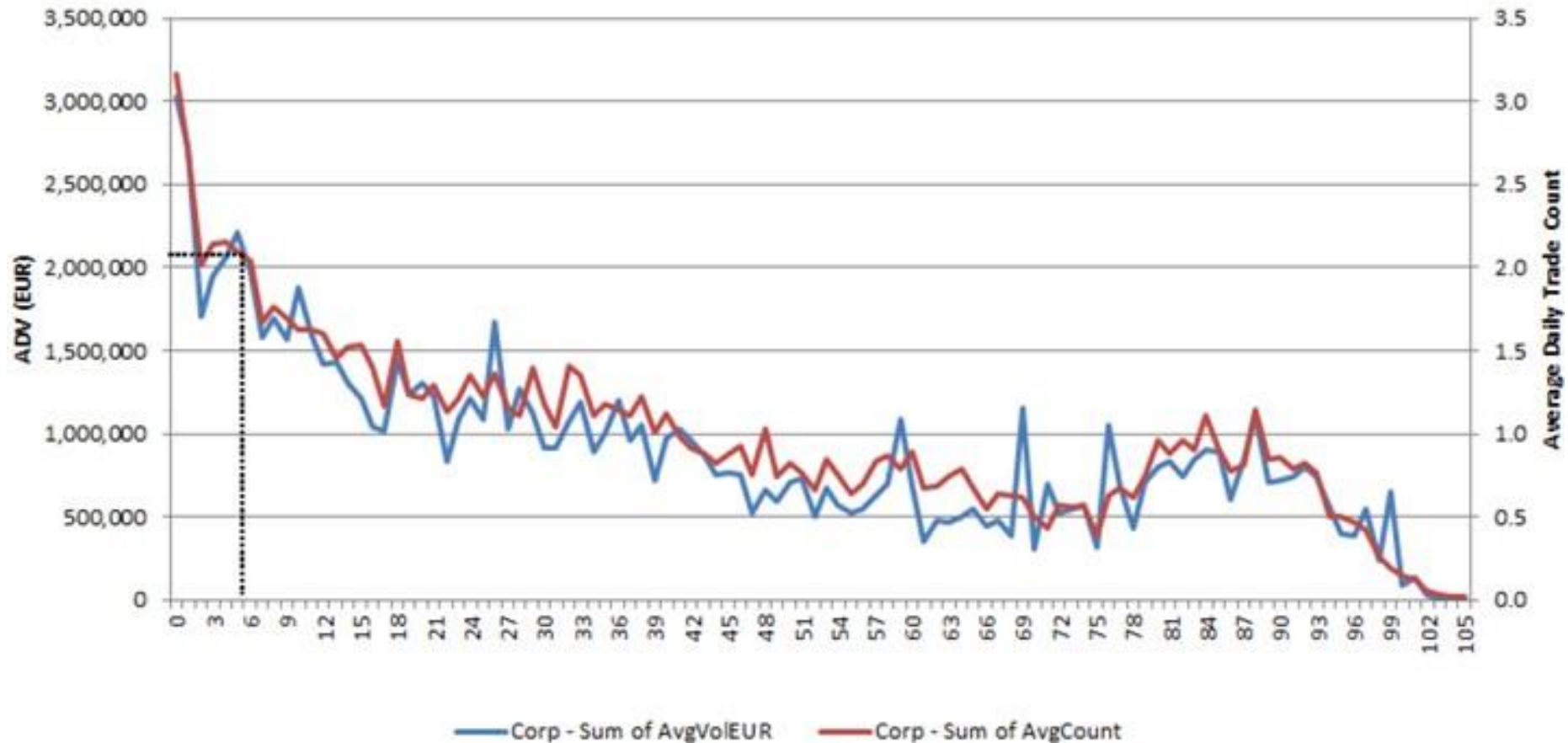
— Average daily trading volume (rhs)

Source: Sifma



Corporate bonds trade mainly when newly issued

Activity in corporate bonds by ISIN and trade counts

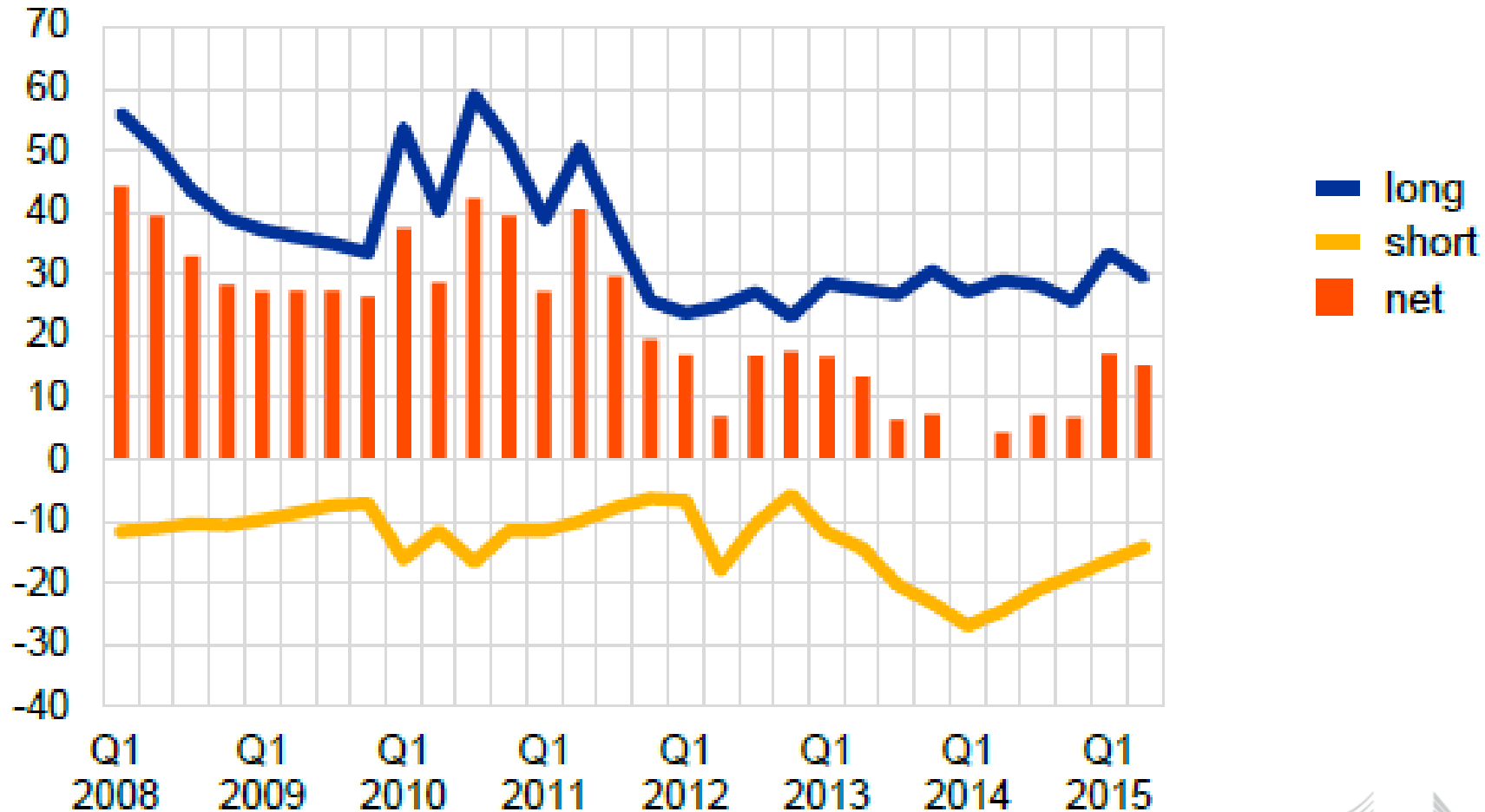


Source: MarketAxess Trax traded data new issuances September 2014 in corporate bonds – total 489 bonds



Dealer inventories have declined markedly

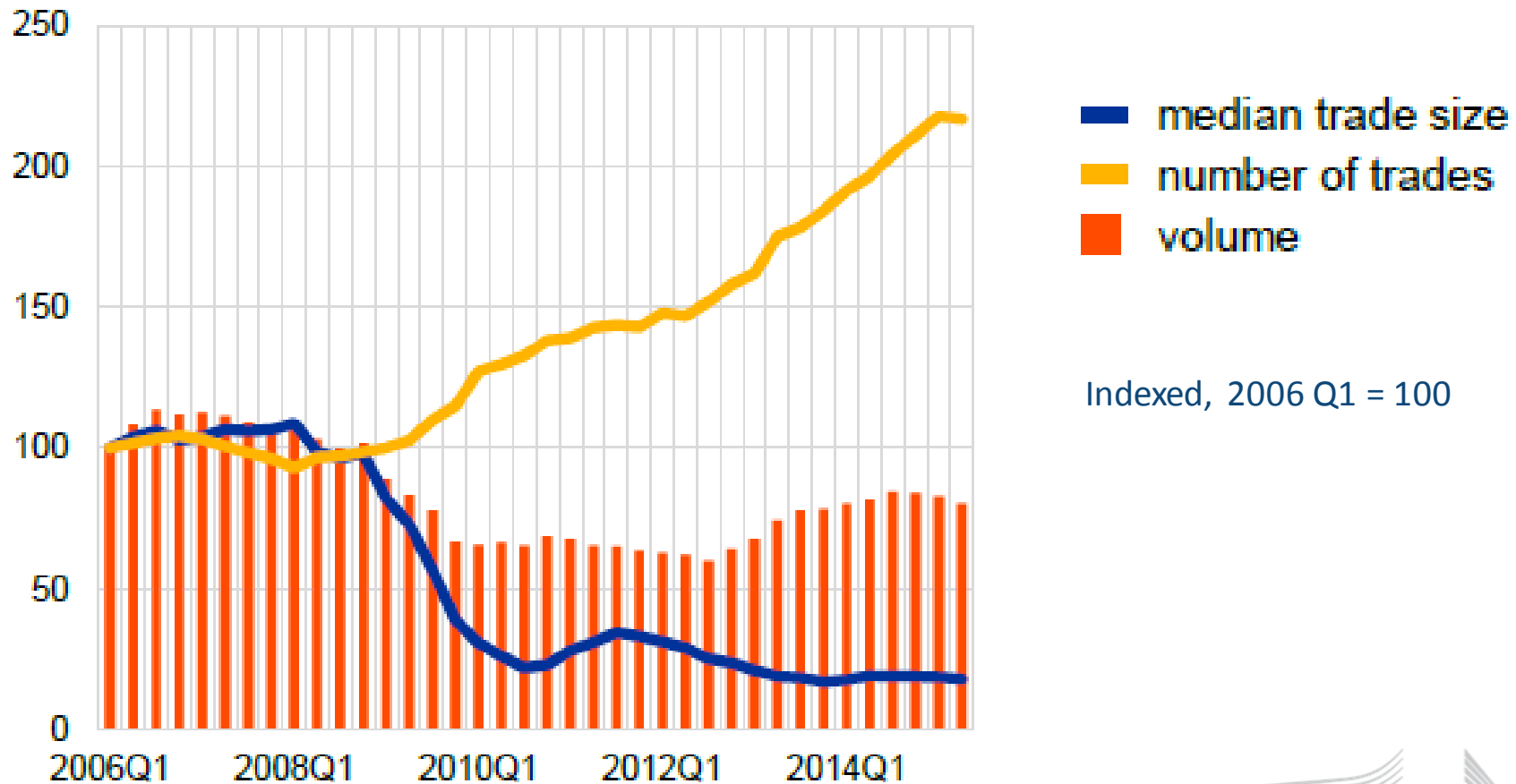
Market-makers' European NFC bond inventories



Source: ESRB data collection (2016)

... but dealers may be working their inventories harder

Volume, median trade size and number of trades by market-makers for NFC bonds



Source: ESRB data collection (2016)

Call for Evidence

- **Liquidity** in corporate bonds and repos has **declined** since the crisis.
- **Regulatory changes**, inter alia, seen as responsible: **no compelling evidence – qualitative arguments.**
- **Commitments by COM in call for evidence:**
 - Assessment of the **functioning of repo markets**;
 - Proposed **phasing in for non-equity instruments** in the new pre-trade transparency regime for MiFID II;
 - Assessment of the **definition of the exemption for ‘market making activities’** from the Short Selling Regulation (SSR);
 - **More proportionate rules for mandatory buy-in of less liquid instruments** under Central Securities Depositories Regulation (CSDR)

Expert Group – Policy questions

- Are **regulatory requirements proportionate** for small issuers?
- Is **market-making necessary** for the ability of buyers and sellers to execute transactions at good prices and in the desired volumes?
- How will **trading/intermediation evolve**? Can **policies and regulations facilitate** this shift?
- What are the **characteristics** that make the market **attractive to investors**?

Expert Group – Process

- 17 members representing **different stakeholder perspectives;**
- **4 focus areas;**
 - **(i) Issuers and issuance, (ii) Demand side, (ii) Intermediation function and market making and (iv) Ecosystem and framing conditions;**
- **Report with recommendations** to improve functioning, to be delivered in **September 2017.**



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Conclusions

