Secretariat of the International Organization of Securities Commissions (IOSCO)
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16 October 2017

Re: Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets

Dear Sirs and Madams,

The Global Financial Markets Association ("GFMA[1]") appreciates the opportunity to comment on the paper and consultation issued in August 2017 by the International Organization of Securities Commissions ("IOSCO"), entitled *Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets* ("the consultation paper").

I. Executive summary and main recommendations

Support for IOSCO's consultation

GFMA supports IOSCO's ongoing examination of the global corporate bond markets and the focus of this consultation on issues related to regulatory reporting, transparency and the collection and comparison of data across jurisdictions. Much has changed since the publication of IOSCO's 2004 report *Transparency of Corporate Bond Markets*, as described in the consultation document. Corporate bond markets have continued to evolve, shaped by market forces and the combined effects of regulation, structural changes, technology, the post-crisis environment, macro-economic factors and other developments. It is therefore reasonable to undertake a broad examination of data reporting requirements in corporate bond markets in the context of recent developments and to update the 2004 Core Measures put forward by IOSCO.

[1] The Global Financial Markets Association brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit http://www.GFMA.org.

Throughout our responses we refer to key regional developments and regulatory frameworks, notably the Financial Industry Regulatory Authority's (FINRA) Transaction Reporting and Compliance Engine (TRACE) in the United States and the Markets in Financial Instruments Directive/Regulation (MiFID II/MiFIR) in the European Union. We have included an Annex at the end of this response with additional observations on Asian markets, the TRACE regime and MiFID II/MiFIR.

Regulatory reporting and public transparency should be clearly distinguished

In our comments we emphasize the distinction between transaction reporting to regulators and public transparency (i.e. information that is shared with the wider market). We are supportive of proportionate transaction reporting bilaterally to regulatory authorities, but note certain risks and concerns that need to be taken into consideration. In relation to public transparency regimes, we note that there can be benefits, but emphasize that very careful assessment and calibration are required before public dissemination requirements are implemented.

Regulators should have access to sufficient information, but proportionality and cross-border consistency are needed

We agree that regulatory authorities should ensure that they have access to sufficient information to perform regulatory functions, including monitoring the build-up of systemic risks, deterring market abuse and ensuring that secondary markets remain stable and competitive. Regulators should have a clear understanding of their regulatory needs and the type of information they need to receive to achieve a specific regulatory objective.

Regulators should avoid duplicative or inconsistent reporting requirements to multiple regulatory agencies or spread across different pieces of regulation. Global coordination and regulatory consistency is always desirable and clearly beneficial to global firms operating across different markets and jurisdictions. Regulatory consistencies are also beneficial for regulators as they facilitate the aggregation of data across different jurisdictions in order to obtain a global view of the market.

Regulators should promote the centralization and consolidation of data, taking into account market efficiency and data security concerns

Market participants have a strong preference for centralization of reporting requirements and data access to the extent that this can be achieved across jurisdictions and agencies. This is particularly relevant in the EU context, with 28 Member States and respective national competent authorities. However, centralized data repositories also carry the risk of becoming a single target for hacks and data breaches. Concerns relating to the security and stability of centralized systems need to be an important consideration.

GFMA members believe that regulators should aim to facilitate the consolidation of data for the emergence of commercial or utility-type solutions in different regional markets. The priorities should be to ensure that the data is easily accessible to market participants, in a timely and non-discriminatory manner, in a safe format and at an affordable cost. Any solutions need to be assessed with careful consideration of impacts to market liquidity.

Assessing the benefits and costs of public transparency regimes

GFMA agrees that the public availability of information, appropriately disclosed and calibrated, can contribute to the price discovery process and enable participants in the market to make more informed investment choices and better assess execution quality.

However, the risk of mis-calibration is significant, with the potential to undermine the overall functioning of corporate bond markets. Market-led developments are advancing market structure in the corporate bond markets and electronification, data collection, data aggregation and other similar efforts by market participants are furthering overall transparency. New regulatory regimes should be introduced if it is considered that they will lead to more meaningful information provided to the market, with benefits outweighing the (often significant) costs involved. We recommend to IOSCO to emphasize this point in its recommendations.

Transparency regimes should reflect the characteristics of corporate bond markets and role of market makers

Corporate bond markets have a number of characteristics which make them different from equities, commodities, foreign exchange and other markets, some of which are dominated by agency-driven execution models. In many jurisdictions and contexts, institutional investors and wholesale firms are the main active participants in corporate bond markets. Within corporate bond markets, there are differences between investment grade and high yield markets.

The role of market makers is an essential feature of corporate bond markets[2]. These markets still predominantly rely on the market maker principal trading model as an indispensable means of allowing investors to trade instruments and restructure their debt portfolios. Market makers place their capital at risk in order to facilitate client orders. This intermediation is possible due to the balance sheet capacity that market makers can allocate to warehouse different corporate bonds. Market makers' activities promote efficiency by narrowing spreads in less liquid markets. A considerable amount of liquidity in corporate bond markets is provided OTC and through bilateral trading platforms as not all instruments will lend themselves to venue trading.

While electronification and a greater participation of non-bank intermediaries in bond markets may contribute to reducing transaction costs or give the appearance thereof, in addition to other advantages, they may also create an illusion of market depth as trading can vary widely between normal conditions and periods of high volatility where liquidity can quickly deteriorate. The true costs of execution are not

[2] For estimates on the volume, median trade size and number of trades by market-makers in corporate bonds in the EU, please refer to the ESRB report *Market liquidity and market-making*, October 2016, p.15 https://www.esrb.europa.eu/pub/pdf/reports/20161005_market_liquidity_market_making.en.pdf?797687aead404cddb51d57b0c7dc9604

always observable, especially where liquidity considerations may result in decisions to not trade at a given point in time. It should not be assumed that moving more trading onto venues will lead to a reduction in overall transaction costs, as price is not the only component of cost. In assessing whether there is suitable liquidity in a particular corporate bond market to support the introduction of additional mandatory transparency, regulators should not consider in isolation the extent to which the product is electronified, traded on venue or the number of active venue participants.

The need for careful, dynamic calibration of transparency regimes

Undue transparency requirements can bring significant risks in the form of disincentivizing intermediation by liquidity providers in corporate bond markets. Appropriate calibration and disclosure arrangements are needed to ensure that market functioning and liquidity are supported and not impaired through the introduction of transparency requirements. The lifecycle of a corporate bond means that trading is more frequent in the early weeks, dropping significantly thereafter. A dynamic calibration is therefore a crucial element in order to take into account the natural liquidity lifecycle of corporate bonds as well as market conditions.

The importance of phased implementation arrangements

When new reporting and transparency requirements are introduced in any jurisdiction, it is essential that regulators establish appropriate implementation timelines and arrangements. MiFID II/MiFIR recognises the need to phase-in some of the pre- and post-trade transparency requirements applicable to bonds which emanate from there being a “liquid market” in an instrument, such that the transparency requirements will initially apply only to the most liquid bonds[3]. The phased-in application and assessment adds an additional layer of security against any unforeseen impact of the new regime on liquidity. We believe that such phased implementation is an example of good practice in view of the significance of the requirements and the objective of not undermining liquidity, but also of the trade-off between liquidity and transparency for principally-traded products. A phased implementation approach was also adopted in the introduction of the TRACE framework in the US.

Pre-trade transparency: regulators should proceed with caution and assess the performance of the MiFID II/MiFIR regime

Pre-trade transparency is an area where regulators should be particularly cautious. Market-led developments are already enhancing the availability of pre-trade information and new regulatory requirements may impose substantial costs with only marginal benefits. We believe that priority should be given to building further evidence and developing sound post-trade transparency regimes with appropriate calibration.

[3] The liquidity thresholds (used to identify liquid bonds) will be set at a more conservative level to start with and will gradually be adapted over a period of four years dependent on a yearly assessment of the initial threshold level and future impact of a move to the next threshold level.

While pre-trade transparency presents benefits for retail investors and small trades in liquid products, making further price information on larger and less liquid trades available to dealers and non-buy-to-hold investors could impair liquidity and increase margins. Authorities should carefully evaluate the performance of the new MiFID II/MiFIR regime in the EU before considering similar requirements in other jurisdictions. We do not believe that the MiFID II/MiFIR pre-trade transparency regime should—at the present time—be treated as a model for how best to meet the policy objective of introducing pre-trade transparency, without very careful consideration of the complex waiver and deferral calibrations that have been required.

Post-trade transparency: benefits can be realized through appropriate calibration

GFMA agrees that post-trade transparency in corporate bond markets, in the form of publication of trade details after a transaction, can have important benefits such as improved price discovery and price formation when properly calibrated.

There are, however, significant risks. We discuss these risks under Recommendation 6, and how they can be contained by having proper calibration arrangements, and allowing sufficient time between the execution and the publication of a transaction. In the MiFID II/MiFIR context, we note that the need to ensure regulatory consistency and alignment in the post-trade transparency regime remains a challenge. Each national competent authority in the 28 Member States has a degree of discretion over the deferral regime it implements for bonds.

Transparency regimes should be specific to each fixed income asset class

Our responses in this consultation refer solely to corporate bond markets. The comments should not be taken as applicable to other fixed income instruments, such as government bonds[4], municipal bonds or structured finance products. Furthermore, the IOSCO recommendations in this consultation are specific to the corporate bond markets and should not be extrapolated to other fixed income markets.

Periodic assessment is essential in an evolving regulatory and market landscape

The full impact of any new regulatory regime can only be assessed following a period of time after implementation. We suggest that IOSCO recommend periodic reviews of corporate bond transparency regimes as a good practice in jurisdictions. Periodic reviews serve to assess the overall effectiveness of

[4] In the US, FINRA has recently created new post-trade reporting requirements for secondary market transactions in US Treasury securities. Prior to the imposition of such reporting, studies of the market noted that the regulators had limited access to Treasury market data and thus were unable to supervise this market as appropriate. The new reporting regime makes available, to the regulatory authorities only, more comprehensive information on secondary market activity. While we believe, consistent with the IOSCO recommendations on corporate bond data collection, that this collection will contribute to the resiliency of the market, requirements for public disclosure of US. Treasury market transactions should not be pursued in the absence of clear, compelling and demonstrable benefits to overall liquidity from such disclosure. Consideration of such reporting should take into account the unique structure of the US Treasury market, with its primary dealer system and large position takers.

regimes, fine-tune requirements and take into account the evolution of the market and technological developments.

II. Comments on IOSCO's Proposed Recommendations

Recommendation 1: **"Regulatory authorities should be able to obtain the information necessary to 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."**

We agree that regulatory transaction reporting requirements are a valuable tool for regulators to conduct their oversight functions, including market surveillance and monitoring systemic risk. Regulators should have access to timely, accurate and detailed information regarding secondary corporate bond markets. Regulatory needs may vary depending on the characteristics of markets and their stage of development. Important questions for regulators to consider include determining the counterparty responsible for the reporting, the reportable products, the data fields and the reportable transactions and how to protect the private and proprietary information gathered.

Authorities should ensure requirements are proportionate and targeted to meet identified needs

In designing transaction reporting regimes, it is important that authorities have a clear understanding of their regulatory needs and the type of information needed to receive to fulfil those needs. The quantity of information is not always an indication of its value and usefulness. Regulators should ensure that they have the necessary systems and capacity to be able to adequately process and analyse data. See also our comments under Recommendation 4.

Benefits of centralization of data and international coordination

Market participants have a strong preference for centralization of reporting requirements and data access to the extent that this can be achieved across jurisdictions and agencies. Where information is collected from multiple sources, this should be consolidated and made available through a centralized source. This is particularly relevant in the EU context, with 28 Member States and respective national competent authorities. Market participants are currently grappling with the implementation of MiFID II/MiFIR requirements involving a combination of EU-level harmonized arrangements and areas of national-level discretion. The UK decision to withdraw from the EU has added an additional layer of uncertainty and complexity in this process.

It is important to avoid duplicative or inconsistent reporting requirements across multiple pieces of legislations. In the European context, concerns have been raised in relation to the regimes introduced under MiFID II/MiFIR (covering multiple financial instruments), EMIR (covering derivatives) and securities financing transaction regulation (SFTR). Where duplication exists, authorities focus on streamlining the different reporting obligations and better coordinating the different reports that firms are required to provide.

Coordinating regulatory reporting obligations across borders, where appropriate, can help recognize and accommodate different data privacy requirements across jurisdictions (see below)—which may be necessary to improve data quality, avoid conflicting requirements, and increase efficiency of data reporting. Poorly constructed and uncoordinated reporting obligations that do not account for the data requirements applicable in the home jurisdictions of participants active in a specific market can significantly impede the flow of cross border investment and capital and risks impeding investors' ready access to investment opportunities. GFMA encourages regulators to harmonize reporting requirements in key jurisdictions to avoid inconsistent or duplicative reporting requirements across jurisdictions, which adds operational complexity and reduces the utility of data gathered for macroprudential purposes.

In implementing transaction reporting requirements, regulators should be mindful that firms often operate across multiple jurisdictions and time zones. Appropriate coordination and alignment of reporting timelines, where practicable, is beneficial.

Considering data privacy and security concerns

The collection, storage and reporting of granular information also raises important questions in relation to security, data privacy and operational efficiency. The transmission of sensitive information between market participants and authorities increases the risk of the personal or sensitive commercial data being inappropriately exposed through error, identity theft or cyber-attack. Regulators should take steps to mitigate these risks and be mindful of local privacy laws that may apply. This an increasing area of concern following recent security breaches. While we recognize and support the benefits of centralized data repositories, they may also lead to a single target for hacks and data breaches. Accordingly, we believe that IOSCO's core recommendations should include a specific element that elevates the importance of data security and an emphasis that the information gathered must be fully necessary given the risks of data security breaches.

Single-sided and dual-sided reporting

In the context of derivatives markets, there has been some debate on the benefits and drawbacks of dual-sided and single-sided reporting regimes. GFMA believes that the case for dual-sided reporting regimes remains unproven, including in the derivatives context, and therefore should not be recommended to be introduced in corporate bond markets in the event that this is under consideration in certain jurisdictions.

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 this Recommendation. Regulators should be clear and open with each other about the underlying methodology for compiling data and how the reporting elements are defined.

The expanded use of a globally-standardised Legal Entity Identifier (LEI) will enable organizations to more effectively measure and manage risk, while providing substantial operational efficiencies and customer service improvements to the industry. A unique ID associated with a single legal entity, the LEI allows for consistent identification of parties to financial transactions, facilitating a consistent and integrated view of exposures. GFMA supports the adoption and promulgation of LEIs globally by stressing their utility and the benefits the system provides to both firms and regulators.

The full potential of the Global LEI System will not be reached until the standard is adopted universally across financial market participants. Where LEI use is mandated in a specific regulation, it is important that this is communicated to market participants well in advance of the requirement entering into application. While the industry is committed to the Global LEI System, the implementation hurdles are still considerable and adequate timelines for implementation of regulation are required in recognition that the marketplace is still in the early phases of adoption. The adoption of LEIs currently varies greatly between jurisdictions. Due consideration should be taken of the impact that a mandate to use LEIs might have on the cross-border activity in the relevant market, and in particular any limitations or disincentives this might introduce for international investors.

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 that regulatory access to certain pre-trade information can assist regulators to better understand corporate bond markets, facilitate effective market monitoring, and help to ensure market integrity and fairness. In relation to the language of Recommendation 3, we strongly suggest IOSCO to use the formulation "*actionable* indications of interest" to ensure clarity and avoid undue record-keeping requirements placed on market participants. It is important to be precise with the use of this and other concepts to avoid confusion and impractical requirements. For example, actionable indications of interest are typically those which are made upon request and should not be confused with indicative pricing that is often shared with clients for information purposes and intended to promote further discussion.

Appropriate pre-trade information can be relevant to regulators to assess the state of market liquidity. In our response to IOSCO's 2016 consultation *Examination of Liquidity of the Secondary Corporate Bond Markets,* we argued that liquidity assessments made solely on the basis of observable trade data have limitations and, when considered in isolation, fall short of providing a complete view of the market environment. Post-trade data can, for example, fall short of reflecting behavioral changes such as participants deciding to reduce trade sizes or not to execute an order. Post-trade data may give the impression of liquidity by recording small trades, but fail to capture unexecuted trades in larger sizes or decisions to trade in small sizes as liquidity was not available in larger sizes.

Information on unexecuted orders and "dropped trades[5]" can be useful to regulators to assess the liquidity environment in corporate bond markets. These metrics can offer insights on market behaviours and trends. We are aware of the challenges in obtaining such data across jurisdictions and we caution regulators to study these issues before imposing new costly requirements.

[5] Trades which occur when one counterparty tries to hit or lift a posted price but the price is not fulfilled by the counterparty and the trade is not executed.

Consideration needs to be given to the way in which participants should provide pre-trade information and how regulators would access it and make use of it. As stated in our comments under Recommendation 1, reporting requirements should be proportionate and targeted to ensure that the information is useful and to avoid undue burdens on market participants.

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."**

GFMA agrees that regulatory collection of post trade data by regulators for secondary market trading in corporate bonds is an important regulatory oversight tool. We agree that the data fields listed in IOSCO's consultation document are appropriate.

We do not believe that the reference to achieving "a high level of reporting" in the Recommendation above is the most appropriate formulation for this Recommendation. It is unclear what is meant by "high" in this context; the quantity of information is not necessarily an indication of its value. We suggest that this reference be removed and the orientation be placed on providing meaningful information while avoiding unintended consequences on liquidity.

In our view, transaction information provided to regulators should serve two primary objectives: (1) ensure that authorities can understand the corporate market environment in their jurisdiction; (2) ensure that authorities can effectively monitor market conduct and compliance with relevant regulations. Policymakers should seek to achieve a balance in relation to the value of an information requirement to authorities and the cost, effort and challenges market participants may encounter in providing the specific information in every transaction. GFMA members are not convinced that such a balance is being achieved under the MiFID II/MiFIR regime, where the number of data fields required on transaction reports is more than doubling from 24 to 65; GFMA believes that the importance and usefulness of some of these data fields is questionable, or could be obtained through other sources[6]. IOSCO may therefore wish to consider a formulation stipulating more clearly that authorities should seek to obtain all information that is necessary and useful to their duties.

Recommendation 5: "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."

While GFMA generally agrees that there is merit in considering steps to enhance the public availability of appropriate pre-trade information relating to corporate bonds, we believe that this is an area where

[6] For example, personal data on traders, beneficiary data, branch data and short selling information.

authorities should proceed with a great degree of caution. Market-led developments are enhancing the availability of pre-trade information and new regulatory requirements may impose substantial costs with only marginal benefits. In our view, priority should be given to building further evidence and developing sound post-trade transparency regimes with appropriate calibration.

MiFID II/MiFIR, set to take effect on 3 January, mandates public disclosure of pre-trade quotes and actionable indications of interest below a certain size for liquid instruments. Authorities should evaluate the experience of this regime in the EU before considering similar requirements in other jurisdictions. It would be premature for IOSCO to recommend the introduction of pre-trade transparency regulation covering all corporate bond instruments until there is enough evidence of the performance of the new regime in the EU and other relevant regimes. For the reasons noted below (and in the Annex) we do not believe that the MiFID II/MiFIR pre-trade transparency regime should be treated at the present time as a model for how best to meet the policy objective of introducing pre-trade transparency, without very careful consideration of the complex waiver and deferral calibrations that have been required.

Ensuring appropriate and dynamic calibration

It is essential for pre-trade transparency to be appropriately calibrated to take into consideration the liquidity of the corporate bond; the size of the transaction as well as the different types of trading systems (including order book, quote driven or voice trading systems).

The need to achieve an adequate and sufficiently granular calibration of MiFID II/MiFIR transparency requirements has been a central–and particularly challenging–component of the regime. For instruments not having a "liquid market", MiFID II/ MiFIR provides for the possibility to waive pre-trade transparency. In other words, in general only instruments with a liquid market will be subject to pre-trade transparency. This highlights the cautious approach that is required when thinking about applying pre-trade transparency to some markets, particularly those where the instruments are not liquid and where, as such, market makers take on significant balance sheet risk for extended periods of time. In addition, MiFID II/MiFIR also introduces possible waivers for large in scale transactions and allows for pre-trade transparency to be calibrated depending on the type of trading systems. A dynamic calibration is a crucial element as it is important for the liquidity thresholds to be recalculated on a regular basis in order to take into account the natural liquidity lifecycle of corporate bonds (i.e. liquidity decreasing quickly after issuance). These are elements that we support.

AFME, GFMA's regional organisation in Europe, has been very engaged in the process to calibrate transparency requirements. The non-equity pre-trade transparency requirements may, if inappropriately calibrated, include illiquid instruments, alerting the market to the upcoming positions and hedging needs of liquidity providers, exposing these to undue market risk ("winner's curse[7]"). Ultimately, investors /

[7] In the market maker model, transparency can create a "winner's curse", making it costly for a dealer to hedge his position. This works as follows. After a market maker executes a transaction with an investor, he enters the interdealer market to hedge the risk. If, however, because of the publication of trade information, the other dealers can predict this dealer's need to hedge, they can benefit by taking up contrarian positions in the interdealer market, thereby making it difficult for the successful bidder to offset the risk of the position. Market makers will need to

clients are left worse off as dealers will factor that risk in their price. AFME has welcomed ESMA's use of the Instrument By Instrument Approach (IBIA) to calibrate bond liquidity and transparency. Recognising the heterogeneous and dynamic nature of bond liquidity, this decision provides the potential for a much more accurate classification of bond liquidity and for more sensitive transparency requirements. However, it remains to be seen whether there is still misclassification of instruments, especially for new issues which depending on when they are issued could be wrongly classed as liquid (false positive) for up to a maximum of 5.5 months.

Importance of phased implementation arrangements

It is essential that transparency regulation allows for a gradual implementation. The risks associated with price transparency can be further contained if the transparency requirements are implemented gradually. This would allow for the market impact to be studied and the calibration to be adjusted if required.

A phased implementation approach, with the calibration changed over time, will help mitigate any potential market disruptions. MiFID II/MiFIR recognizes the need to phase-in some of the pre- and post-trade transparency requirements applicable to bonds, which emanate from there being a "liquid market" in an instrument, such that the transparency requirements will initially apply only to the most liquid bonds. The liquidity threshold (used to identify liquid bonds) will be set at a more conservative level to start with and will gradually be adapted over a period of four years dependent on a yearly assessment of the initial threshold level and future impact of a move to the next threshold. This phased-in application adds an additional layer of security against any unforeseen impact of the new regime on liquidity[8]. A phased-implementation approach was also adopted by FINRA in the US with regards to post-trade transparency.

GFMA strongly supports the proposed phasing in of waivers under MiFID II/MiFIR and requirement for ESMA to assess liquidity annually before proceeding to the next step of the phase in. We believe such phased implementation is an example of good practice in view of the significance of the MiFID II/MiFIR requirements and the objective of not undermining liquidity.

We therefore suggest that IOSCO recommends phased implementation involving liquidity assessments as a good practice to be considered in other jurisdictions.

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compensate for this risk of adverse price movements by increasing the transaction costs they charge to investors. Investors will require compensation for these increased costs from the issuers of bonds (governments, companies), in the form of higher borrowing costs.

[8] While the MiFID II/MiFIR regime extends transparency to corporate bonds by 3 January 2018, the framework will phase-in the application of certain parts of the new transparency regime to mitigate possible liquidity risks to bond markets. Under the phased-in approach, initially less demanding transparency requirements would be applied and ESMA will be required to assess liquidity annually before proceeding to the next step of the phase in. These would be gradually strengthened over a period of four years. Consequently, significantly fewer instruments would be subject to the full rigors of the transparency regime at the start of MiFID II than after the four-year phase-in process, subject to the ex-ante ESMA liquidity assessments.

Post-trade transparency should be prioritized

As noted under Recommendation 6, GFMA agrees that post-trade transparency in corporate bond markets can have important benefits such as improved price discovery and price formation.

The case for introducing pre-trade transparency requirements for all types of corporate bonds is less compelling at the present time. In several jurisdictions, indicative quotations, websites, dealer-runs and various platforms already provide investors with a sufficiently large amount of pre-trade information for appropriate price formation. As market participants seek workflow efficiencies, there continues to be meaningful voluntary investment by both buy-side and sell-side in pre-trade data technologies. Efforts span trading venues, third party order management systems as well as proprietary tools. Unlike prescriptive regulatory pre-trade transparency requirements that may have unintended liquidity implications, these voluntary efforts are needs-based, solve for cost-benefit and are conducive to trading personnel workflow.

In our view, while pre-trade transparency presents benefits for retail investors and small trades in liquid products, making further price information on larger and less liquid trades available to dealers and non-buy-to-hold investors could impair liquidity and increase margins. In particular, excessive transparency may disadvantage market makers when reselling their products; therefore, they would be less willing to accept the greater risk and would demand a higher price. Specifically, to the detriment of both investors and dealers, execution of large trades would be made more difficult. The problems would be felt more acutely in scenarios of market stress, where liquidity provision by market making firms is most needed.

We believe that IOSCO members should prioritize post-trade transparency, subject to calibrations and safeguards as described under Recommendation 6. We note that the studies referenced by IOSCO as providing evidence that transparency can be beneficial to liquidity refer to the evidence provided by the TRACE framework in the US, which covers post-trade transparency only.

Further assessment of pre-trade transparency regimes is needed – MiFID II/MiFIR should not be taken as a model for other jurisdictions without careful consideration

As noted by IOSCO, most pre-trade information is currently provided where bonds are listed and traded on an exchange. There are only few jurisdictions that have pre-trade transparency requirements for listed or unlisted corporate bonds traded on non-exchange venues or OTC.

The introduction of wide-ranging requirements in the EU, applicable from 3 January 2018, goes beyond the regulatory framework in other jurisdictions. We believe that it is prudent to continue to evaluate the experience in the EU and other jurisdictions that have introduced pre-trade transparency regimes before recommending a broader adoption of pre-trade transparency regimes.

Regulators should carefully evaluate if the introduction of pre-trade transparency will lead to more meaningful information available to market participants and if the benefits will outweigh the significant costs involved for market participants. It remains to be seen whether the MiFID II/MiFIR regime will meet these tests.

We stress that the MiFID II/MiFIR regime, despite merits which we note in this response[9], should not be seen as a model to be followed in other jurisdictions for the design of pre-trade transparency regimes, without very careful consideration of the complex waiver and deferral calibrations that have been required. This view relates in particular to the pre-trade transparency regime for Systematic Internalisers, which we believe raises questions and concerns which will need to be assessed following implementation.

The broader liquidity environment must be taken into account in any transparency regime

Authorities should carefully consider the liquidity environment in corporate bond markets prior to reviewing current transparency requirements. Current signs of fragility in these markets, combined with the ongoing implementation of major reforms emanating from the G20/Basel Committee[10], suggest that authorities should exercise a high degree of caution in considering new requirements that may compromise liquidity.

In our response to IOSCO's 2016 consultation *Examination of Liquidity of the Secondary Corporate Bond Markets,* we argued that there are sufficient early warning signals to suggest that regulation and other market factors are contributing to a reduction in certain aspects of secondary liquidity in corporate bond markets that is likely to be exacerbated by the unwinding of quantitative easing or another stressed market situation. GFMA continues to have concerns about the impact to market liquidity due to unwinding or other stress events. It is particularly important that regulators consider transparency requirements in the context of stress situations where liquidity provision by market makers is most needed.

There are examples of recent analysis by authorities suggesting that the liquidity environment may be uncertain or deteriorating.

In the US, the SEC report *Access to Capital Market Liquidity*[11] suggests that evidence for the impact of regulatory reforms on market liquidity is mixed, with different measures of market liquidity showing different trends. The report notes that although estimated transaction costs have decreased, corporate bond trading activity in recent years has also become somewhat more concentrated in less complex bonds and bonds with larger issue sizes.

New analysis conducted by the UK FCA[12] suggests there has been a decline in liquidity in the UK's corporate bond market over the past two years. The analysis, which combines both traditional and non-

[9] Including phased implementation and calibration according to instruments sizes and liquidity, whereby transparency is applied to instruments in certain sizes for which there is a "liquid market".
[10] See the GFMA-IIF 2016 response to IOSCO *Public Comment on Examination of Liquidity of the Secondary Corporate Bond Markets*, p. 23
[11] SEC 2017 report to Congress available at: https://www.sec.gov/files/access-to-capital-and-market-liquidity-study-dera-2017.pdf
[12] FCA 2017 research available at: https://www.fca.org.uk/insight/new-evidence-liquidity-uk-corporate-bond-market

traditional measures of liquidity, indicates trading conditions have generally become more difficult from 2014/2015 onward. The FCA analysis found:

- A decline in dealer quote rates on electronic bond trading platforms;
- A slight widening of some quoted and effective bid-ask spreads; and
- An increase in transaction based measures such as the price impact of trades and round-trip costs.

In the EU context, the European Commission expert group on corporate bond markets is expected to publish a wide-ranging examination on the state of corporate bond market liquidity and the regulatory framework. We encourage authorities to carefully review the conclusions of this assessment.

GFMA is also currently engaging with IOSCO's Research Department on its investigation of what happens to liquidity in corporate bond markets when trading / investing conditions become stressful. We welcome this dialogue with IOSCO and look forward to the outputs of this investigation.

Understanding the multifaceted nature of liquidity and role of market makers in corporate bond markets

Liquidity is a simultaneously abstract and quantifiable concept. Liquidity can be defined as the ability to execute an order at the given price, with as little market impact as possible. The features that tend to be associated with liquid markets include low transaction costs, immediacy in execution, and the ability to execute large transactions with limited price impact.

While details about trades can be quantified and tracked over time, participants may have differing views about the secondary market liquidity environment at a given point, depending on their market activities and strategies. For this reason, we believe that liquidity assessments made solely on the basis of observable trade data have limitations and, when considered in isolation, fall short of providing a complete view of the market environment.

At its heart, market making is liquidity provision through the ability to promptly absorb investors' demand or supply of a financial instrument. This is also known as "immediacy" – the ability to expedite the trading interests of independent counterparties in a timely and cost-effective way. Competing market makers do this by quoting buy and sell prices, as well as providing on-request quotes, to ensure a two-way market. Market makers place their capital at risk in order to facilitate client orders. This intermediation is possible due to the balance sheet capacity that market makers can allocate to warehouse different corporate bonds.

The market making function is crucial in corporate bond markets as these markets often do not feature sufficient numbers of buyers and sellers with exactly matching buying and selling interests at all times. Intermediation is needed to align differing trading demands and ensure liquidity provision. Market makers' activities promote market efficiency by narrowing spreads in less liquid markets. We note that a considerable amount of liquidity in corporate bond markets is provided OTC and through bilateral trading platforms as not all instruments will lend themselves to venue trading.

Recommendation 6: **"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."**

GFMA agrees that post-trade transparency in corporate bond markets, in the form of publication of trade details after a transaction, can have important benefits such as improved price discovery and price formation when properly calibrated.

Key considerations in post-trade transparency

There are, however, significant risks. Public disclosure of post-trade information requires extreme caution to avoid unintended consequences such as disclosing firms' proprietary data, unveiling counterparty identification, or discouraging liquidity provisioning by market makers by their ability to reasonably manage the risks. These consequences can lead to increased transaction costs for investors and increased borrowing costs for issuers. These risks can be contained by having proper calibration arrangements, and allowing sufficient time between the execution and the publication of a transaction.

Core features of a properly calibrated regime including the following: reporting time delays to be determined by the *size or type of the transaction* and, in certain circumstances, exclusion of the volume of the trade from reporting (volume omission), or publication in aggregated form. It is vital that these elements are included in a post-trade transparency regime to ensure that the risks are mitigated while optimising the beneficial effects of post trade transparency. Time delays, volume omission or aggregated publication allow a market maker to facilitate investors' demands to buy and sell, without exposing them to adverse price movements (the winner's curse), which in turn leads to higher transaction costs for investors and ultimately higher borrowing costs for issuers. Time delays allow dealers to hedge their risk *before* the trade is made public. Volume omission, the masking of the size of the traded ticket for tickets above a certain threshold, makes it easier for a dealer to hedge; it reduces the time delays that are needed before publication of the trade information.

To decide in an appropriate way how long the delay should be for a certain trade or above what trade size a volume should be omitted, it is crucial to take account of the *liquidity profile* of the instrument, as well as the type of product. The less liquid a bond is, the longer it may take for a dealer to unwind a position, and the greater the risk that the price moves away from the market maker when hedging its position. IOSCO should be careful not to undervalue evidence on this point[13]. This means that the damaging effects

[13] We draw attention to the findings concerning trading activity in high yield bonds in the study Asquith, Paul and Covert, Thomas R. and Pathak, Parag A., *The Effects of Mandatory Transparency in Financial Market Design: Evidence from the Corporate Bond Market* (4 September 2013), referenced in IOSCO's consultation document. This study is referenced by IOSCO with regard to the decline in price deviation after the introduction of TRACE, but it does not

of a winner's curse (and hence of increased transaction and borrowing costs) are the greatest for the least liquid assets and the smallest for the most liquid assets. These risks can be mitigated by having longer time delays for less liquid assets and shorter time delays for more liquid assets.

It is important that the need for a dynamic calibration is reflected in any framework to account for the decrease or increase of liquidity in the market or of specific assets. The liquidity of fixed income assets can differ greatly over time. First, liquidity generally changes over the maturity of a bond. A bond is most liquid right after issuance, after which it becomes significantly less liquid the closer it gets to its maturity date. Indeed, trading activity in corporate bonds is concentrated within the first five-to-ten days after issue, after which they are more likely to be held by long-term buy-and-hold investors and trade less frequently. Second, events may cause liquidity to change. The changes in the liquidity of an asset and the can be captured by a dynamic calibration. Finally, the issue size of a bond is also an important factor to take into account when looking to assess its liquidity, as traditionally, the larger the issue size, the more liquid the bond tends to be.

The need for sound calibration, phased implementation and assessing the liquidity environment also apply in relation to post-trade transparency

Our comments under Recommendation 5 on the need to ensure appropriate calibration, the importance of phased implementation and the need to take into account the broader liquidity environment also apply in relation to post-trade transparency as the concept of a "liquid market" is central to the calibration of the post-trade regime.

Additional comments on the TRACE regime

SIFMA, GFMA's US regional organisation, believes that one area where a recalibration of the TRACE regime should strongly be considered is the reporting of large or block size transactions. Although the current TRACE framework masks the actual size of block trades, the dissemination of transaction information within 15 minutes of the time of the trade can negatively impact the facilitation of large block trades and the liquidity of the corporate bond market generally. While such timing has always been a concern of market participants, market dynamics have changed in recent years and the current reporting structure more significantly serves to reduce dealers' appetite to facilitate block trades. The frictions caused by the current framework can raise search costs and transaction costs for market participants and do not serve to promote efficient, liquid and orderly markets. A recent US Department of the Treasury report on capital markets acknowledged that "the reduced frequency of block trades suggests more difficulty in moving

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highlight the fact that the paper also finds that trading activity declined significantly for less liquid bonds. As noted in the paper:
"Using new data and a differences-in-differences research design, we find that transparency causes a significant decrease in price dispersion for all bonds and a significant decrease in trading activity for some categories of bonds. The largest decrease in daily price standard deviation, 24.7%, and the largest decrease in trading activity, 41.3%, occurs for bonds in the final Phase, which consisted primarily of high-yield bonds. These results indicate that mandated transparency may help some investors and dealers through a decline in price dispersion, while harming others through a reduction in trading activity."

blocks of risk".[14] While the current framework that provides for the masking of block trade size was clearly created in recognition of these frictions, changes to liquidity conditions and market structure warrant a reconsideration of the existing framework.

Additional comments on the MiFID II/MiFIR regime

In the European context, we note that the need to ensure regulatory consistency and alignment in the post-trade transparency regime remains a challenge. Each national competent authority in the 28 Member States has a degree of discretion over the deferral regime it implements for bonds. For non-equities the standard deferral regime allows for a T+2 deferred publication. National competent authorities can further calibrate the deferral regime, either by requiring some transparency within that T+2 timeframe, or "enhancing" the standard deferral and allow a supplementary deferral for volume information which may extend up to 4 weeks.

We are concerned that the misalignment of national regimes in the EU can lead to liquidity fragmentation and market distortions. A jurisdiction with a longer deferral period for a specific sector might be deemed more attractive than a jurisdiction implementing the standard deferral time. This could influence participants' behaviors such as who to trade with and the prices that are provided. A harmonized and flexible approach at EU level around the longest possible deferral for less liquid instruments (which would include corporate bonds), is likely to be preferable, although this remains a subject under consideration by GFMA members.

The calibration of liquidity and the risk of misclassification of bonds (i.e. an illiquid bond incorrectly being classified as liquid) will remain crucial areas of examination in the new regime. Under MiFID II/MiFIR until 2019 bonds over EUR 1BN issuance will be deemed liquid (after 2019 this threshold will reduce to EUR 500M). However, the lifecycle of a corporate bond means that trading is more frequent in the early weeks, dropping significantly thereafter. Therefore, depending on when the bond is issued it could be deemed liquid for a maximum of 5.5 months (i.e. until the next instrument specific liquidity determination calculation takes place). As a result, it is possible that the market sees issuance clusters timed so this time frame is the shortest possible (2.5 months).

For a detailed explanation of these post-trade reporting requirements, please refer to the September 2017 AFME-KPMG publication *MiFID II/MiFIR post-trade reporting requirements – Understanding bank and investor obligations*[15].

Avoiding undue risk to liquidity providers through publicly available information

Authorities also should be mindful of the possibility that market participants can reverse engineer different pieces of information that are made public to discern market positions and thus expose liquidity

[14] See US Department of the Treasury Report: A Financial System That Creates Opportunities/Capital Markets at https://www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf

[15] https://www.afme.eu/en/reports/publications/mifid-ii--mifir-post-trade-reporting-requirements/

providers to undue risks. In the MiFID II/MiFIR context, there are concerns about the possibility to combine publicly available post-trade data (which will expose the exact size of specific large trades even after any supplementary deferral period) with the information published by liquidity providers/market-makers/SIs to identify which dealer executed specific large transactions, deduce the remaining inventory held by that dealer even after the quarterly reporting window has elapsed, and to use that information against that dealer. This is especially critical considering Systematic Internalisers which put their own capital at risk and might carry positions even in liquid instruments for more than a quarter. This would discourage provision of liquidity in large transaction sizes.

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."**

GFMA strongly agrees with IOSCO that there are clear benefits in promoting a centralization and consolidation of data.

A priority for regulators is to carefully consider the way the consolidated data should be offered. GFMA members believe that regulators should aim to facilitate the consolidation of data for the emergence of commercial or utility-type e solutions in different regional markets. The priorities should be to ensure that the data is easily accessible to market participants, in a timely and non-discriminatory manner, in a safe format and at an affordable cost.

As noted by IOSCO, in the US the vast majority of corporate bond data are required to be reported to FINRA's TRACE system. There is a small amount of trading of corporate bonds that occurs on exchanges in the US that is not consolidated with the TRACE data, but is readily accessible.

In the EU, MiFID II/MiFIR contains a framework to introduce a consolidated tape that would include corporate bonds that are listed or unlisted and traded on a trading venue or OTC. These requirements will not be in effect however, until September 2019, and we have yet to see whether this will effectively come to life. Consolidated tape providers (CTPs) will design systems in accordance with pre-defined parameters, and will be required to consolidate data at a high degree from Approved Publication Arrangements (APAs) and trading venues.

APAs will be responsible for publishing details of executed trades to the market on behalf of firms as close to real time as possible, on a reasonable commercial basis. The data should be made available free of charge 15 minutes after publication for non-equity instruments like bonds (falling to 5 min in 2021). APAs must disseminate information in a manner that ensures fast market-wide access on a non-discriminatory basis. They must also check a firm's trade messages for accuracy and completeness (requesting the re-submission of any identified erroneous messages).

Different models supporting the submission of post-trade reports to an APA are emerging. Regardless of the model utilised, the entity with the trade reporting obligation retains the regulatory responsibility for timeliness, completeness and accuracy of its reporting. The responsibility to ensure that the information transmitted is timely, complete and accurate, and taking reasonable steps to verify the timeliness, completeness and accuracy of reports submitted on their behalf, if that should be the case, cannot be outsourced.

An EU-wide consolidated tape has not yet been realized. This would involve the emergence of a technology provider that would assume the role of assimilating multiple APA feeds onto a consolidated tape. The fact that CTPs for bonds are scheduled for after the launch of MiFID II/MiFIR does not seem optimal or conducive to the goal of greater transparency.

As mentioned under Recommendation 1, centralized data repositories also carry the risk of becoming a single target for hacks and data breaches. Concerns relating to the security and stability of a consolidated tape system need to be an important consideration.

Again, GFMA appreciates the opportunity to contribute to this study. Please contact Allison Parent (aparent@gfma.org) or Pablo Portugal (Pablo.portugal@afme.eu) should you require any additional information.

Sincerely,

Allison Parent
Executive Director
GFMA

Annex: Additional observations on Asian markets, MiFID II/MiFIR and TRACE

Asian markets

In Asia, markets are relatively small, fragmented and less liquid than other markets. Trades in even the benchmark sovereign, corporate and financial bonds of issuers from within the region tend to be sporadic. At times, it can take a while to fill even a single client order, which may appear to be of reasonable size in a developed market context, but which could be large in an Asian context. Imposing developed market pre- and post-trade transparency and data reporting norms on Asian financial instruments (by virtue of their also having an EU listing, for instance) may not be appropriate, given the very different market conditions in Asia.

TRACE regime

The Financial Industry Regulatory Authority's (FINRA) Transaction Reporting and Compliance Engine (TRACE) in the U.S. facilitates the mandatory reporting of over-the-counter secondary market transactions in eligible fixed income securities. The original TRACE reporting obligations for corporate debt securities were implemented in a gradual, phased-in approach that in incremental steps reduced the reporting times of transactions to FINRA in recognition of both liquidity concerns and operational obstacles. While the system has been in place for well over 10 years, FINRA only recently expanded the reporting requirements to certain mortgage backed securities and other securitized products. In that regard, FINRA has showed an appreciation of the idiosyncrasies of individual markets and the need to tailor requirements accordingly, much as IOSCO has suggested should be the case in any reporting regime. Regulators should consider recalibration of reporting requirements to address changes in market structure and any unintended consequences that may have manifested in financial markets. As per our comments under Recommendation 6, we believe that one such area where recalibration should be strongly considered is the reporting of large or block size transactions.

MiFID II/MiFIR

In Europe, the new MiFID II/MiFIR regime, set to take effect on 3 January 2018, will introduce profound changes to the EU regulatory framework for reporting and transparency in corporate bond markets.

Among the key changes, MiFID II/MiFIR mandates public disclosure of pre-trade quotes and actionable indications of interest below a certain size, for instruments that are deemed liquid; it also introduces post-trade transaction data requirements designed to provide market participants with near real-time broadcast of basic trade data around executed trades.

MiFID II/MiFIR pre-trade transparency requirements clearly go further than those introduced so far in other jurisdictions, including the TRACE system in the US, which currently covers post-trade transparency only.

Not only does MIFIR mandate a pre-trade transparency regime for venues, but it also extends this obligation to Systematic Internalisers when making firm quotes away from venues. In some respects, however, MIFIR Article 18 imposes on Systematic Internalisers a higher obligation than if the same quote had been made on venue by the same quoting entity under RFQ or Voice Trading Systems, which may not be a desirable precedent to adopt universally. The efficacy of MIFIR in achieving the right balance between delivering a meaningful pre-trade transparency regime and maintaining liquidity depends entirely on setting at appropriate levels the various liquidity and waiver thresholds. This has proven to be a complex task, involving when to define new issues as liquid, recognizing that bonds become less liquid as they age and the size thresholds above which a waiver may be available.

In the imposition of a pre-trade transparency regime for corporate bonds we hold the view that pricemakers should not be obliged to make firm quotations to their clients. These are not like primary dealer markets in sovereign bonds. The provision of non-firm indicative quotes is an essential service to investors and enables dealers to adjust prices to market circumstances. Additionally, dealers may not be set up to provide real-time quotes on bonds that do not actively trade; therefore, such an obligation would be costly and could potentially create an additional barrier to entry for new market participants.