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October 16, 2017

Via Electronic Mail

Alp Eroglu
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
Spain

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

Dear Mr. Eroglu:

ICI Global¹ supports IOSCO's objective of making the secondary corporate bond markets more transparent—to regulators and the public—without unduly disturbing market liquidity. IOSCO's consultation report on regulatory reporting and public transparency in the secondary corporate bond markets (Consultation Report), however, fails to provide regulators with a roadmap to accomplish its laudable goal.² To reduce the risk of harming liquidity, IOSCO should recommend that regulators take an incremental and data-driven approach to corporate bond market transparency.

As steady investors in the corporate bond and other fixed income markets, regulated funds have a strong interest in ensuring the quality and integrity of these markets. This letter explains our members' view of the recommendations in the Consultation Report. Part I urges IOSCO to recommend that regulators find the right balance of transparency and liquidity to benefit the corporate bond markets. Part II explains why regulators should pursue public transparency in a data-driven and

¹ ICI Global carries out the international work of the Investment Company Institute, the leading association representing regulated funds globally. ICI's membership includes regulated funds publicly offered to investors in jurisdictions worldwide, with total assets of US\$27.2 trillion. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of regulated investment funds, their managers, and investors. ICI Global has offices in London, Hong Kong, and Washington, DC.

² Board, *Regulatory Reporting and Public Transparency in the Secondary Corporate Bond Markets, Consultation Report*, IOSCO (August 2017), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD578.pdf>.

continued

incremental manner and why regulatory reporting must be a prerequisite for this common-sense approach. Part III describes how IOSCO could assist regulators in implementing such an approach to benefit their own markets and avoid the potential pitfalls of transparency.

I. IOSCO Should Encourage Regulators to Find the Right Balance of Liquidity and Transparency to Benefit the Corporate Bond Markets

The Consultation Report takes the view that transparency “facilitates efficiency and confidence in the market, which may lead to increased liquidity and trading” and recommends that jurisdictions implement pre- and post-trade transparency requirements.³ Although transparency optimally encourages and facilitates liquidity, we believe an appropriate balance must be struck to accomplish these two (at times competing) goals. We therefore urge IOSCO to remind regulators that efforts to increase transparency must not come at the price of diminished liquidity in the corporate bond markets, particularly in light of the significant developments in recent years.

Since the financial crisis, regulated funds have faced a changing landscape for corporate bond trading.⁴ Economic and regulatory pressures have altered the role that dealers play in the secondary corporate bond markets. Today, dealers hold fewer corporate bonds in inventory than they did before the crisis and make markets more frequently in an agency—rather than a principal—capacity. Our members report that these changes have affected the immediacy with which trades are concluded. Newly developed technologies and trading protocols compensated for these changes, in part, and provide regulated funds and other end-holders of corporate bonds the ability to seek liquidity from a broader pool of market participants than they could several years ago. As IOSCO found, these changes have resulted in a mixed picture of liquidity in the corporate bond markets.⁵ Given the evolving nature of liquidity in the secondary corporate bond markets and the significant changes in the corporate bond market ecosystem, we believe it would be prudent for regulators to tread carefully to avoid damaging liquidity.

II. Regulatory Reporting Is a Necessary First Step to Facilitate a Data-Driven Approach to Transparency

The Consultation Report finds that transparency is an “important element in capital markets” that enables investors to evaluate whether they paid a fair price for a purchase and provides investors with information regarding the trading activity of others.⁶ Although we generally agree that additional

³ *Id.*

⁴ We described these changes from the perspective of regulated funds in our letter in response to IOSCO’s consultation on corporate bond market liquidity. See Letter from Dan Waters, Managing Director, ICI Global, to Alp Eroglu, IOSCO, dated September 30, 2016, available at <https://www.ici.org/pdf/30289.pdf>.

⁵ See Board, *Examination of Liquidity of the Secondary Corporate Bond Markets, Final Report*, IOSCO (February 2017), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD558.pdf>.

⁶ Consultation Report, *supra* note 2, at 11.

transparency may ultimately be appropriate for corporate bond markets, IOSCO's recommendations on public transparency are premature, particularly for jurisdictions that lack adequate data about their corporate bond markets.⁷

Regulators should base their efforts to increase transparency in a corporate bond market on data from that market, and we welcome IOSCO's recommendations encouraging authorities to gather information about the markets they supervise. Regulators should understand how the significant changes in the corporate bond markets in recent years have affected liquidity before introducing new public disclosure requirements for two reasons. First, comprehensive data on corporate bond market activity would allow a regulator to design new transparency requirements to minimize possible negative effects on liquidity. Second, an authority should understand the baseline level of corporate bond liquidity in a market it supervises to assess how new transparency requirements affect the market.

IOSCO therefore should recommend that authorities implement comprehensive regulatory reporting requirements to improve their understanding of the secondary corporate bond markets before attempting to increase public transparency. An effective regulatory reporting regime would provide data about pre- and post-trade market activity, including information about the frequency and size of transactions, the quality and depth of liquidity on a bond-by-bond basis, and the prices at which market participants transact. This information would assist regulators in obtaining a better understanding of market activity and facilitate effective surveillance that enhances market integrity and fairness in trading.⁸

To implement properly a regulatory reporting regime, IOSCO should recommend that authorities adopt state-of-the-art cybersecurity policies and procedures tailored to counteract the risks associated with collecting and storing data on the secondary corporate bond markets.⁹ All regulatory reporting regimes should include adequate information security measures to protect the sensitive and valuable market data that authorities collect. Although no information security program can eliminate completely the threat of a data breach, an IOSCO recommendation on cybersecurity would ensure that

⁷ *Id.* at 14-16 (acknowledging a trend toward increased transparency in the corporate bond markets, but noting that pre-trade transparency regimes are limited and post-trade transparency regimes have been implemented unevenly).

⁸ To ensure that regulators have high-quality data to analyze (while minimizing burdens on market participants), IOSCO should recommend that regulators leverage the reporting capabilities and interconnectedness of dealers and trading platforms in designing reporting requirements.

⁹ Unauthorized access of confidential transaction information could harm regulated funds and other investors by enabling predatory traders or cyber criminals to construct fund position information or reverse engineer fund trading strategies. A data breach also could undermine certain of the benefits that IOSCO hopes regulatory reporting will deliver, such as enhancing market integrity. IOSCO should include an information security recommendation, particularly given the US Securities and Exchange Commission's (SEC) recent disclosure that "a software vulnerability [in its EDGAR system] . . . was exploited and resulted in [unauthorized] access to nonpublic information" and "may have provided the basis for illicit gain through trading." Public Statement, SEC, Chairman Jay Clayton (September 20, 2017), *available at* <https://www.sec.gov/news/public-statement/statement-clayton-2017-09-20>.

regulators understand the importance of providing adequate protections for the sensitive and commercially-valuable information of market participants.

III. IOSCO Should Recommend that Regulators Use the Data from Regulatory Reporting to Implement Public Transparency Requirements Incrementally

Authorities should strive to establish public transparency regimes that maintain orderly trading and give the public as much information as possible. The appropriate level of public transparency, however, likely will vary according to the nature of liquidity in each jurisdiction, so policymakers should—as part of their data analysis—determine how best to implement transparency rules in their own market. IOSCO can help guide regulators to this objective by recommending that authorities consider four factors to inform any proposed public dissemination requirements: (1) the goals such disclosure would be intended to achieve; (2) the data elements that would be disclosed publicly to achieve those goals; (3) whether those data elements would apply to all corporate bonds or only a subset; and (4) whether publicly disclosing this data will achieve those goals without harming the market.

These considerations should help regulators protect liquidity and enhance public transparency in a deliberate and data-driven manner. This approach should enable an authority to assess the effects of new public dissemination requirements on its market and identify quickly whether liquidity decreases following the implementation of a new requirement. By contrast, a regulator that notes diminished liquidity following the introduction of omnibus transparency reforms will not know which part of its reform package harmed liquidity and therefore might not know what steps to take to restore liquidity. The implementation of the Markets in Financial Instruments Directive (MiFID) II in January of next year could raise this circumstance.¹⁰ Any studies that attempt to analyze the effects of MiFID II may have difficulty identifying the source of market changes following MiFID II's implementation, in part because so many changes occurred at the same time.¹¹ We urge IOSCO to recommend that other regulators pursue transparency in a more incremental fashion to ensure they will be able to evaluate the effects of transparency on liquidity.

IOSCO also should consider two other recommendations that would complement the incremental and data-driven approach to transparency. First, IOSCO should recommend that

¹⁰ The reforms provided by this law include a host of corporate bond regulatory reporting requirements and certain pre- and post-trade transparency requirements for many corporate bonds. For example, trading venues must continually disseminate certain pre-trade data, including information on current bid and offer prices and the depth of interest at those prices, while systematic internalizers, in certain circumstances, must disclose firm quotes in a manner which is easily accessible to other participants and must do so on a reasonable commercial basis. Post-trade transparency requirements include publishing the price, volume, and time of certain corporate bond transactions “as close to real-time as technically possible.” Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, Title II Ch. 2 Art. 10(1), available at <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014R0600>.

¹¹ It also might be difficult to measure the impacts of MiFID II because EU regulators presently lack adequate information to provide a clear view of the corporate bond markets they regulate before MiFID II implementation.

authorities categorize bonds according to their liquidity and adopt public transparency rules suitable for each category. Due to the sheer number of different corporate bond issues and the diverse nature of these instruments, liquidity varies dramatically from bond to bond. Generally, more liquid bonds can support a higher level of public dissemination than less liquid bonds, but authorities should use data to determine the appropriate level of transparency for the bonds trading in their jurisdiction. Without differentiating among bonds, regulators will risk providing little meaningful information for more liquid bonds, reducing liquidity of less liquid bonds, or both. Authorities could use the data from regulatory reports to increase transparency requirements gradually, as liquidity conditions warrant.

Second, IOSOC should recommend that authorities use data from regulatory reports to tailor public dissemination requirements according to transaction size, if necessary. If all transactions are disseminated the same way, regardless of size, dealers might become reluctant to facilitate block trades because public dissemination of these transactions could make hedging unduly expensive. This result could harm regulated funds and other investors that rely on block trading to execute investment strategies and provide returns to their investors.

The data provided by regulatory reporting would allow authorities to determine the size at which a corporate bond transaction would qualify as a block for purposes of public dissemination, which should vary depending on the liquidity profile of the bond. Preliminarily, we would expect block trade thresholds to be higher in more liquid markets. Analyzing data also would enable regulators to adopt appropriate protections for block trades based on an empirical assessment of the benefits that block trading brings to asset management clients versus the potential market-wide benefits of increased transparency for block trade data.¹² To avoid disrupting liquidity, authorities should err on the side of treating more transactions as block trades—at least initially—and narrowing the scope of transactions subject to block trade protections, if data supports this decision.

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¹² Block trade protections should be data-driven and might vary from market to market. Potential measures to accommodate block trades could include masking the size of a block transaction and delaying public dissemination of block trade details.

IOSCO should recommend regulators take an incremental approach to transparency based on real data. We believe this type of approach would promote market stability by ensuring that regulators have strong empirical evidence to support their policy choices and the flexibility to adjust, if necessary, to minimize unintended consequences to the liquidity of the corporate bond market. We appreciate the opportunity to provide feedback on the Consultation Report. If you have any questions on our letter, please feel free to contact me, Jennifer Choi, Associate General Counsel, at (202) 326-5876, or George Gilbert, Assistant General Counsel, at (202) 326-5810.

Sincerely,

/s/ Dan Waters

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