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Bond Market Transparency

25 January 2016

What is transparency?

- **Transparency**: public disclosure of information regarding prices and volumes
  - **Pre-trade**: disclosure of prices and quantities on offer
  - **Post-trade**: disclosure of price and quantity of a trade
- Information may be provided through data vendors at a cost
- Transparency may be required by regulators

There are trade-offs to transparency

- Transparency is useful for pricing, and assessment of both liquidity and execution costs

Price competition:	Information leakage:
More accurate and timely pricing results in lower costs.	Transparency may reduce dealers' incentives to provide liquidity if their trading intentions are revealed.
Benefits particularly pronounced for smaller investors and dealers.	Problems may be more acute in less-liquid and more-concentrated markets, and for larger trades.

- Transparency may act through other channels:
  - Confidence in market fairness
  - Participation and entry
  - Identification of market conduct issues

Varying degrees of transparency are possible

- Transparency providers and regulators have tools to mitigate information leakage, including:
  - Delays
  - Exemptions
  - Volume caps and rounding

International Work on Transparency

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Global regulations and structural change

❖ Regulations

- In the US, the **Trade Reporting And Compliance Engine (TRACE)** has provided transparency for almost all corporate bond trades since 2002
- In Europe, the **Markets in Financial Instruments Directive II (MiFID II)** will require increases in pre and post-trade transparency in fixed income markets

❖ Structural change

- Increased use of **electronic trading platforms** reduce operational costs of transparency
- The **US Treasury recently released a notice seeking public comment** on structural changes in the market for Treasury securities, including on the appropriate level of public pre and post-trade transparency

US Trade Reporting And Compliance Engine (TRACE)

- Since 2002, the US Financial Industry Regulatory Authority (FINRA) has required almost all OTC corporate bond trades to be reported to TRACE
  - Data is publically disseminated after 15 minutes
  - Includes price, time, and size of transaction (subject to caps)
- Peer-reviewed studies generally concluded that increased transparency from TRACE decreased investors' trading costs for corporate bonds in the US[1]
  - The effect was more pronounced for retail-sized trades
- One study noted a decrease in trading activity[2]
- A variety of market participants have recently advocated delaying TRACE reporting of large trades from 15 minutes to T+1 or T+2
  - "Many of the market participants we spoke to felt that increased transparency had undermined liquidity."[3]

[1] Bessimbinder, Maxwell and Venkataraman (2006), Edwards, Harris and Piwowar (2007), Goldstein and Hotchkiss (2007)
[2] Zhang (2012), Asquith, Covert and Pathak (2013)
[3] Oliver Wyman and Morgan Stanley joint report (2015)

Markets in Financial Instruments Directive II (MiFID II)

- MiFID II is a directive from the European Union to the European Economic Area for increased financial regulation in many asset classes, including on transparency
- Pre-trade requirements:
  - Trading platforms must continuously publish current bid/offer and depth
  - Requirements will depend on type of trading system (request for quotes, order book, etc.)
- Post-trade requirements:
  - Commercially (paid): close to real time, at most **15 minutes** after execution
  - At no cost: 15 minutes after execution
  - Delays for both to be shortened to 5 minutes in 2020
- Delays and waivers for both pre and post-trade requirements are possible for large block trades/orders, and illiquid bonds
  - After 48hrs, everything except volume must be made public
  - Volume can be exempt for up to 4 weeks
- Most jurisdictions expect MiFID II to be implemented by January 2017

Transparency in Canada

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Canada has many transparency infrastructures, including

	Source	Available data
Pre-trade	**Data vendors** and **dealer pages**	Real-time indicative quotes by dealer
	CanDeal	Composite real-time indicative quotes
	Inter-dealer brokers	Executable quotes
Post-trade	**CanPX**	One-hour delayed prices on ~450 corporate bonds; **CSA requirement**
		Government of Canada yields
	TMX/CDS Fixed Income Pricing Service (FIPS)	Prices on all transactions are released end-of-day; volume cap of $2m; 14-day delay for illiquid bonds
Bench-mark	**FTSE/TMX** (Formerly DEX/PC-Bond)	Average (with outliers removed) indicative closing prices

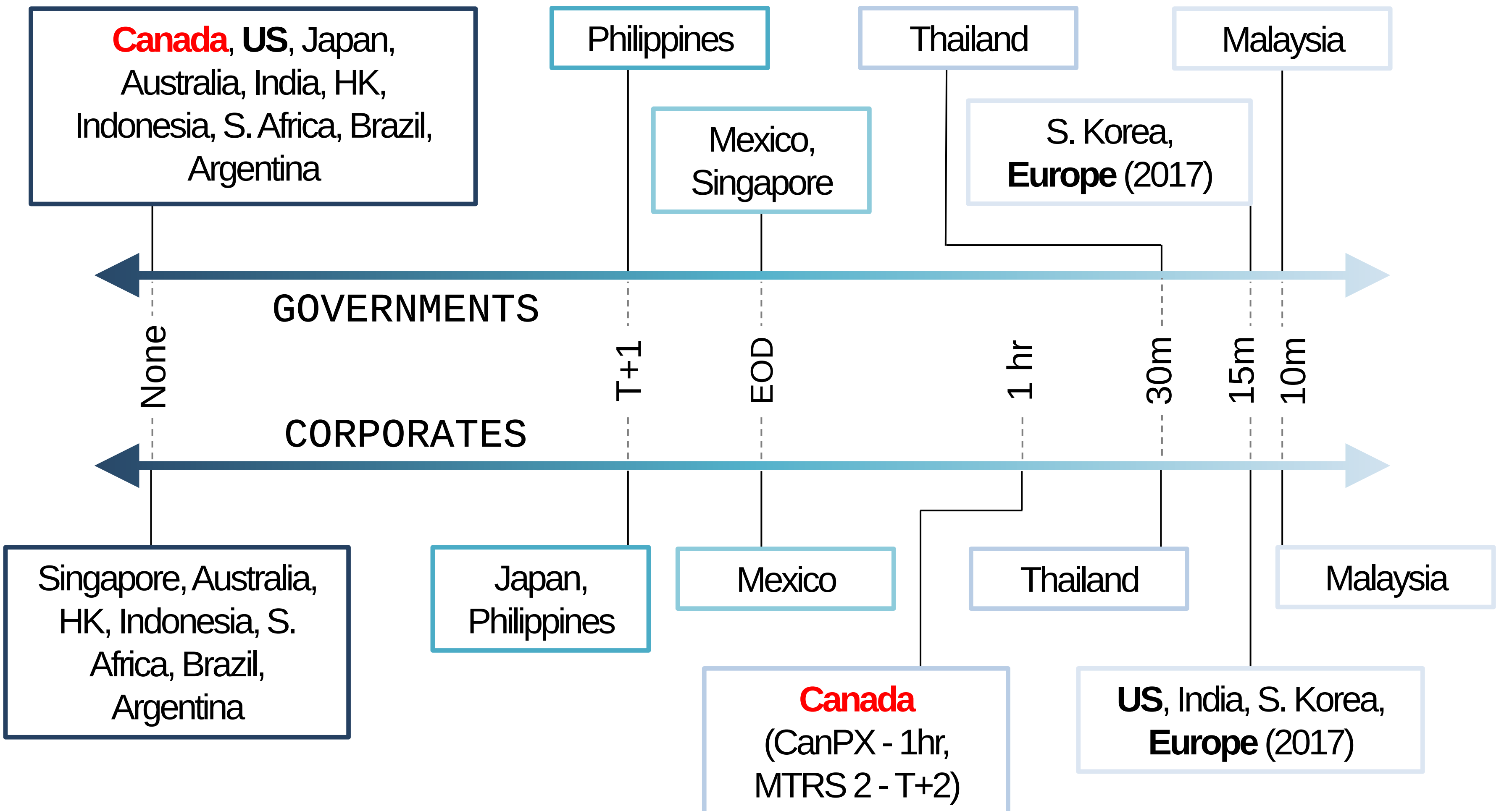
Market Trade Reporting System 2.0 (MTRS 2.0)

- **MTRS 2.0 is a regulatory debt-market surveillance system**
  - It collects reports on all bond and repo trades executed by IIROC-registered broker-dealers
  - Each report contains a trade's timestamp, price, quantity and other terms/fields
- **MTRS 2.0 is the successor to older system, "MTRS 1"**
  - Both MTRS 1 and MTRS 2.0 were developed jointly by IIROC and the Bank of Canada
  - The older system collected only weekly aggregate trade data
  - IIROC launched MTRS 2.0 in November 2015

CSA proposal for transparency for corporate bonds

- The CSA has proposed that MTRS 2.0 provide public post-trade transparency for all corporate bonds:
  - Initially for CanPX bonds (~450) in mid-2016
  - Aiming to cover all corporate bonds in 2017, with delays, volume caps, and rounding
  - Dissemination will be T+2 with volume caps of $2M for investment grade, $200K otherwise
- Industry comments on the proposal are now available on the OSC's website
- Government bond trades are currently exempt from transparency requirements
  - The exemption is up for renewal in 2018

Reporting delay requirements in Canada and other jurisdictions



Points for discussion

- Are current levels of pre and post-trade transparency in Canadian fixed-income markets satisfactory?
  - Do they foster fair and efficient markets?
  - Are volume caps, delays and rounding calibrated appropriately?
- Are there recent structural, regulatory, cyclical changes that affect the optimal level of transparency?
- Is the optimal level of transparency different for government bonds?
  - Is the exemption from CSA requirements still needed?