

CSA Staff Notice and Request for Comment 21-315

Next Steps in Regulation and Transparency of the Fixed Income Market

September 17, 2015

I. Introduction

This notice describes the steps that Canadian Securities Administrators (CSA) staff (CSA staff or we) are taking to:

- enhance regulation in the fixed income¹ market, and
- identify opportunities to improve market transparency and better protect investor interests.

On April 23, 2015, staff of the Ontario Securities Commission (OSC) published a report titled *The Canadian Fixed Income Market 2014* (the **Report**).² The Report presented a fact-based snapshot of the \$2 trillion fixed income market in Canada, with particular emphasis on the \$500 billion in corporate debt outstanding.³ The Report also highlighted the following:

1. fixed income data available is limited and fragmented across a number of sources, which makes it difficult to conduct a comprehensive assessment of the fixed income market;
2. the secondary fixed income market is a decentralized, over-the-counter market where large investors have significantly more bargaining power than small investors;
3. there is limited adoption of electronic trading and alternative trading systems, especially for corporate bonds; and
4. direct retail participation in the primary and secondary fixed income market is low and retail investors typically access the fixed income market by purchasing investment funds.

The purpose of this notice is to set out the CSA staff's plan to enhance fixed income regulation to:

1. facilitate more informed decision-making among all market participants, regardless of their size;
2. improve market integrity; and
3. evaluate whether access to the fixed income market is fair and equitable for all investors.

Each of these steps is discussed in the sections below.

II. More Informed Decision-Making among All Market Participants

¹ Unless otherwise indicated in this notice, the references to fixed income include both government and corporate fixed income securities.

² Available at <http://www.osc.gov.on.ca/documents/en/Securities-Category2/20150423-fixed-income-report-2014.pdf>.

³ Data as of December 2014.

In the Report, OSC staff noted that transparency in the fixed income market is generally limited. Fixed income information is not publicly disseminated like it is in the equity market and is not easily available to market participants. This applies not only to fixed income order and trade information, but also to information regarding the cost of investors' transactions and data relating to fixed income offerings. There is no comprehensive source of reliable trading data available to dealers, investors or regulators. Furthermore, the Report identified the fact that there is more information available to (mainly larger) institutional investors. These investors can leverage their dealer networks to access pre-trade information. However, more limited information is available to smaller institutions and retail investors.

These issues are being addressed by implementing performance reporting requirements, making changes to the System for Electronic Document Analysis and Retrieval (**SEDAR**), and working with the Investment Industry Regulatory Organization of Canada (**IIROC**) to increase post-trade transparency for corporate debt securities. Furthermore, regulators will have access to fixed income data, as described below in this Notice.

1. *Implementation of Cost and Performance Requirements in the Client Relationship Model - Phase 2 (CRM 2)*

CRM 2 amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations (NI 31-103)* and the rules of IIROC and the Mutual Fund Dealers Association of Canada, when fully implemented by July 2016, will help investors that are clients of dealers and advisers better understand the cost of their fixed income transactions. Specifically, investors will receive information regarding the total amount of any mark-ups, mark-downs, commissions or other service charges they paid, or the total amount of the commissions charged and notification that they already remunerated the dealer firm.⁴

Registered firms (dealers, advisers and investment fund managers) will also be required to deliver investment performance reports to their clients.⁵ These reports will include information regarding changes in the market value of investments over a specific time period and total percentage returns for clients' accounts⁶ and will provide investors information that would help them assess how their investments, including fixed income investments, performed over time.

2. *SEDAR Disclosure*

Investors will benefit from enhancements to SEDAR that were implemented earlier in 2015. SEDAR is the electronic system for the official filing of documents by public companies and investment funds across Canada. Its purpose is to facilitate electronic filing of securities information required by the CSA, allow for the public dissemination of that information and provide electronic communication between electronic filers, filing agents and the CSA. As of April 2015, SEDAR has been enhanced to make it easier for investors to find relevant documents for fixed income offerings, especially trust indentures and credit agreements.

⁴ Paragraph 14.17(1)(e) of NI 31-103.

⁵ Subsection 14.18(1) of NI 31-103.

⁶ Section 14.19 of NI 31-103.

Specifically, two new document types have been added to SEDAR:

- documents affecting rights of security holders – trust indentures regarding debt, which include trust indentures and supplemental trust indentures filed in connection with a debt offering; and
- material contracts – credit agreements, which include credit agreements, both in the context of prospectus filings and continuous disclosure filings.

3. *Transparency for Fixed Income Securities*

As part of the objective to enhance fixed income regulation, CSA staff intend to focus on increasing transparency for corporate debt securities,⁷ which is currently mandated in National Instrument 21-101 Marketplace Operation (**NI 21-101**). Specifically, we propose that trade information for all corporate debt securities executed by dealers be made publicly available, subject to delayed dissemination and volume caps, by the end of 2017. This part of the notice outlines the existing regulatory requirements and the steps to be taken to expand transparency for corporate debt securities.

(a) *Transparency requirements applicable to fixed income securities*

The transparency requirements for fixed income securities are included in Part 8 of NI 21-101. These requirements mandate the reporting by dealers of order and trade information for fixed income securities to an information processor (as required by the information processor). The information processor is an entity that collects, aggregates and publicly disseminates the data.⁸

(i) *Existing transparency requirements for government debt securities and the transparency exemption*

NI 21-101 sets out transparency requirements for government debt securities. Specifically, marketplaces and inter-dealer bond brokers are required to report order or trade information, or both, to an information processor. However, an exemption from these transparency requirements is in place and was recently extended until January 1, 2018, through amendments to NI 21-101. As indicated in the notice published with the amendments,⁹ no other jurisdiction has mandated transparency for government debt securities. The extension was granted in order to allow CSA staff to monitor international developments, including the expected implementation of the transparency regime that will be established across the European Union by the new Markets in Financial Instruments Directive (**MiFID II**) and the Markets in Financial Instrument Regulation (**MiFIR**) adopted by the European Commission,¹⁰ and to determine whether the NI 21-101

⁷ A corporate debt security is defined in NI 21-101 as a debt security issued in Canada by a company or corporation that is not listed on a recognized exchange or quoted on a recognized quotation and trade reporting system.

⁸ The requirements applicable to information processors are outlined in Part 14 of NI 21-101.

⁹ Please refer to CSA Notice of Approval for Amendments to National Instrument 21-101 *Marketplace Operation* available at http://www.nbsc-cvmb.ca/nbsc/uploaded_topic_files/21-101-CSAN-2014-10-23-E.pdf.

¹⁰ When in force, MiFIR will establish a new transparency regime which extends to bonds, structured products, emission allowances and derivatives.

transparency requirements for government debt securities should be implemented or whether changes are appropriate.

(ii) Existing transparency requirements for corporate debt securities

Transparency requirements for corporate debt securities are also included in NI 21-101. For corporate debt securities, marketplaces, inter-dealer bond brokers and dealers are required to report order and/or trade information to an information processor, as required by the information processor. These requirements are currently in force and information is provided to an information processor for corporate debt securities. CanPX Inc. (**CanPX**) has been an information processor for corporate debt securities since 2003.¹¹ It sets criteria and designates the corporate debt securities (the **Designated Corporate Debt Securities**) for which it receives and disseminates post-trade information from those participants that have at least a 0.5% share of the relevant market.¹² The information disseminated by CanPX is subject to volume caps, which mask the true dollar size of large trades, and is disseminated every hour.

CanPX disseminates trading data through information vendors, which make it available to their clients. It also displays on its website, free of charge, consolidated end-of-day pricing information for the Designated Corporate Debt Securities that traded on the previous day.

(iii) Transparency in other jurisdictions

We note that transparency requirements for corporate debt securities are also mandated in foreign jurisdictions like the U.S., through the Trade Reporting and Compliance Engine (**TRACE**) administered by the Financial Industry Regulatory Authority, and Europe, where MiFID II mandates transparency for corporate bonds admitted to trading on trading venues.¹³

(b) CSA staff's proposal to enhance transparency for corporate debt securities

As noted above, CSA staff's goal is to expand corporate bond transparency. There are two aspects to the plan to achieve this goal. The first is to leverage off of the fixed income reporting platform that will be introduced by IIROC starting November 2015 (this platform is described below) and have IIROC act as an information processor under NI 21-101. The second is to expand the transparency of corporate bonds so that information is available for all corporate bonds, subject to a dissemination delay and to volume caps, by the end of 2017.

(i) IIROC as the information processor

We are of the view that we can best achieve the goal of transparency for trades in all corporate debt securities by leveraging IIROC's fixed income reporting platform which is being built to implement IIROC Rule 2800C *Transaction Reporting for Fixed Income Debt Securities* (**IIROC**

¹¹ In June 2014, the CSA determined that it was not contrary to the public interest for CanPX to continue to act as an information processor until December 31, 2015. Please see CSA Staff Notice 21-314 Information Processor for Corporate Debt Securities, available at http://www.nbsc-cvmnb.ca/nbsc/uploaded_topic_files/21-314-CSAN-2014-06-27E2.pdf.

¹² CanPX makes the selection, which is subject to CSA approval, in accordance with a set of selection criteria which are published on its website and which include trading volumes, whether the bonds are included in domestic Canadian corporate bond indices, issues size and whether the bonds are highly liquid. The criteria are found at <http://www.canpxonline.ca/selectioncriteria.php>. At September 10, 2015, 415 corporate debt securities were included in the list of securities designated by CanPX, which resulted in coverage of 58% of the corporate debt securities traded over a one year period.

¹³ The MiFID II rules are expected to become effective in January 2017.

Debt Reporting Rule).¹⁴ As described in further detail below, such an approach would ensure that a source of historical information for trades in all corporate debt securities is in place, and that market participants report their trade information to a single entity for both regulatory and transparency purposes.

The IIROC Debt Reporting Rule requires IIROC dealer members to report fixed income trade information for all fixed income transactions (government and corporate debt) to IIROC for surveillance purposes. The reporting will be done through IIROC's fixed income trade reporting system, the Market Trade Reporting System (**MTRS 2.0**), and will start on November 1, 2015.¹⁵

It is CSA staff's intention to use the information reported to MTRS 2.0 relating to corporate debt securities to implement our transparency proposal. Specifically, IIROC will act as an information processor for corporate debt securities¹⁶ under NI 21-101 and will publicly disseminate trade information relating to those securities, subject to a dissemination delay and volume caps (described below).

There are a number of benefits to having IIROC act as the information processor and disseminate corporate bond trade information. Specifically:

- The implementation of the IIROC Debt Reporting Rule is timely, as the reporting by IIROC dealer members to IIROC will start in November 2015 and will be complete by November 1, 2016.
- All fixed income trades executed by IIROC Dealer Members will be reported to IIROC in compliance with the IIROC Debt Reporting Rule. This will ensure the availability of a comprehensive source of corporate debt trade information that will be used to achieve transparency.
- The accuracy and completeness of data will be subject to regulatory oversight, which will ensure the integrity of the data that will be publicly disseminated.
- No additional system development or other efforts on the part of the dealers will be required to provide data to a transparency platform, as they will already be required to provide data to comply with the IIROC Debt Reporting Rule. This will also ensure that there will not be duplicative reporting by dealers.

IIROC fully supports this approach and will actively participate in this transparency initiative.

It is expected that CanPX's status as an information processor will be extended to accommodate a transition period after the first stage of the implementation of the IIROC Debt Reporting Rule. A notice indicating any extension will be published at a later date.

(ii) *Expanding transparency for trades in corporate debt securities*

¹⁴ Available at http://www.iiroc.ca/Rulebook/MemberRules/Rule02800C_en.pdf.

¹⁵ In the first stage, effective November 1, 2015, dealers that are Government Securities Distributors (GSDs) and affiliates that are GSDs will be required to report. All other dealers will be required to report their transactions in the second stage, effective November 1, 2016.

¹⁶ In order to be an information processor under NI 21-101, IIROC will file Form 21-101F5 *Initial Operation Report for Information Processor* and will need to be recognized by the Autorité des marchés financiers.

The second aspect of the proposed plan to enhance corporate bond transparency is to expand the information available publicly. This will be achieved by making a subset of the information reported through the MTRS 2.0 system publicly available, in accordance with the requirements in NI 21-101. In the near term, the information that will be made publicly available relates to trades in Designated Corporate Debt Securities and trades marked as “retail” in MTRS 2.0. In the longer term, information for all corporate debt securities will be made available. Below, we include a description of the information that will be made transparent and the proposed timelines for implementation of the enhanced transparency framework.

The information reported through MTRS 2.0 that will be made publicly available includes:

- information about corporate debt securities as reported by dealers, as prescribed by NI 21-101; and
- for each corporate debt security, only the data fields that would facilitate more informed decision-making for investors. While we are considering the specific data fields that will be made publicly available, it is our expectation that the information disseminated would include, for each corporate debt security, the name of the security, price, coupon, yield, volume traded (subject to volume caps), the transaction type, indication of whether the trade was an inter-dealer trade or whether it was a client purchase or sale, date and time of the trade, and settlement date.

In the context of reviewing transparency in the corporate debt market, we have met with a variety of stakeholders including both buy-side and sell-side firms. We discussed with them the potential impact of additional transparency on liquidity, and how any potentially negative impact can be mitigated. They indicated that delayed dissemination and volume caps are potential ways to mitigate this impact. We agree, and note that our approach to increase transparency includes the use of such mechanisms to mitigate any possible negative impact of increased transparency. In our view, the approach to increase transparency is a balanced one that addresses the need for information but does so in a way that addresses concerns that too much transparency can impact liquidity. Further detail is provided below.

A. Dissemination delay

The information will not be disseminated in real-time. Data reported into MTRS 2.0 is reported to IIROC one day following the trade (T+1).¹⁷ As result, by basing the platform for corporate debt transparency on MTRS 2.0, the information will be publicly disseminated no earlier than on T+1 and likely, on T+2, in order to give IIROC the time needed to process the information. The timing of the dissemination will be determined and published before the end of 2015, along with the specific data fields related to the information that will be disseminated by IIROC and details regarding the availability of the data.

We recognize that dissemination on a T+2 basis constitutes a longer delay when compared to CanPX’s one-hour dissemination delay. However, we are of the view that the availability of a comprehensive source of information that would help achieve transparency for all corporate debt

¹⁷ The reporting timeframes are set out in subsection 2.5(a) of IIROC Rule 2800C. Trades that occur after 6 p.m. on a business day and trades that occur outside of a business day are reported on T+2.

trades, the broader availability of this information to investors, and the efficiency achieved from using MTRS 2.0 for transparency purposes (i.e. dealers will only be required to report their trade data once) are benefits that far exceed the potential impact of a longer delay. We will monitor the dissemination delay with a view to decreasing it over time.

B. Volume caps

The information to be published by IIROC will also be subject to volume caps. This means that, for those trades that have volumes over \$2 million for investment grade corporate bonds and \$200,000 for non-investment grade corporate bonds, the actual volumes will not be shown in the display. Instead, the volumes will be reflected as \$2 million+ and \$200,000+, respectively. These volume caps are the same that are used today and are described in the Companion Policy to NI 21-101.¹⁸ The existing volume caps that mask large-volume trades will protect the anonymity of large-sized transactions. Over the long-term, as the MTRS 2.0 data is analyzed, we will determine if the size of the volume caps continues to be appropriate.

C. Proposed timeline to implement post-trade transparency for corporate debt securities

As noted above, it is CSA staff's goal to achieve transparency for trades in all corporate debt securities by the end of 2017. We have considered how to achieve this goal in light of:

- the fact that IIROC will be implementing the IIROC Debt Reporting Rule in two phases (described below); and
- concerns that have been raised globally about a decrease in the liquidity in corporate debt markets, and the potential impact of additional transparency on liquidity.¹⁹

It is intended that transparency for all corporate debt securities will be phased in over the next two years in two phases, as follows:

- in Phase I (expected to occur in mid-2016), IIROC, as an information processor, will disseminate post-trade information for all trades in the Designated Corporate Debt Securities and for retail trades²⁰ for all other corporate debt securities reported to IIROC; and
- in Phase II (expected to occur in mid-2017), IIROC will disseminate information for all trades in all corporate debt securities and for new issues of corporate debt.

Each phase is scheduled to occur approximately six months after the completion of each phase of the roll-out of MTRS 2.0.²¹ The specific dates of the transparency implementation phases will be confirmed before the end of 2015 and are subject to the readiness of MTRS 2.0 and the corresponding transparency platform.

It is our view that providing for a phased-in approach enables IIROC to facilitate the smooth

¹⁸ See paragraph 10.1(3)(b) of the Companion Policy to NI 21-101.

¹⁹ Specifically, concerns have been raised globally about a potential decrease in the liquidity of the fixed income markets due to a number of factors, including an increase in corporate bond issuances coupled with, some believe, decreases in dealers' inventories resulting from changes in regulation. We have also heard these concerns raised by Canadian buy-side and sell-side firms during our discussions regarding liquidity and transparency.

²⁰ The IIROC Debt Reporting Rule requires that retail trades be identified with a retail indicator.

²¹ See footnote 15.

implementation of the IIROC Debt Reporting Rule and MTRS 2.0 before having to disseminate the information. This will also help mitigate the concerns regarding the impact of increased transparency on liquidity.

III. Improved Market Integrity

Another key theme identified in the Report was the lack of a comprehensive source of reliable trading data available to regulators.

As noted above, IIROC has recently adopted the IIROC Debt Reporting Rule to address this gap. The new requirements will allow regulators to better monitor the market and identify and address market integrity issues. We support these efforts and will oversee the implementation of the IIROC Debt Reporting Rule as it is phased in. We will also analyze the debt transaction data going forward to understand market trends and inform policy decisions.

In addition, we are reviewing whether it is appropriate to require exempt market dealers to report fixed income trade information to IIROC, so that IIROC can establish a comprehensive source of information that would include all relevant market participants. We are also considering whether transparency requirements should apply to that information. We will report on the status of our review and next steps in due course.

IV. Evaluating Access to the Fixed Income Market

Another issue being examined relates to access to the fixed income market. A number of market participants, in particular smaller institutional investors, have raised concerns that they have limited ability to participate in new debt offerings.

In the Report, OSC staff noted that underwriters appear to focus their efforts on marketing bonds to large institutions because these investors:

- purchase larger blocks of inventory, reducing marketing costs and the associated markups;
- provide signaling information that helps the underwriter price the issue appropriately; and
- benefit from cross-selling, where prior relationships reduce marketing efforts.

Regulation for the allocation of initial offerings is found in IIROC's Dealer Member Rule 29 *Business Conduct*, which prohibits allocations of new issues to non-client accounts ahead of clients. This rule does not cover allocations among clients.

To examine this issue, a working group comprised of IIROC and CSA staff has been established. This group will conduct a comprehensive review of dealers' allocation practices among clients to collect data related to how initial debt offerings are allocated between the different market participants and understand how allocations are done. Based on this review, we will determine whether further regulatory action is needed.

V. Conclusion

In this notice, we have set out the steps that CSA and IIROC staff are taking to enhance regulation in the fixed income market and identify opportunities to improve market transparency and better protect investor interests.

We acknowledge that fixed income secondary market trading is complex and our plan covers only a few areas. However, we are of the view that ensuring fixed income data is available to regulators and enhancing corporate debt transparency constitute significant first steps in modernizing the regulatory framework for the fixed income market and is a necessary pre-condition for further policy work in this area.

By having access to a comprehensive source of fixed income data, regulators will be able to properly monitor the trading activity in the fixed income market, identify issues and trends, and determine whether changes to the regulatory framework would be appropriate. With increased transparency, investors will be able to assess the quality of their executions and raise any issues with the dealers or, if applicable, the regulators. We acknowledge the need to balance transparency and liquidity, and are of the view that the plan described above, including the use of delayed dissemination and volume caps, creates that balance.

VI. Deadline for Comments

Please submit your comments on the proposed plan to enhance fixed income regulation and on the timelines for phasing in fixed income transparency on or before November 1, 2015. If you are not sending your comments by email, please send a CD containing the submissions (in Microsoft Word format).

VII. Where to Send Your Comments

Address your submissions to all of the CSA as follows:

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority (Saskatchewan)
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Deliver your comments **only** to the addresses below. Your comments will be distributed to the other participating CSA jurisdictions.

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VIII. Comments Received Will Be Publicly Available

Please note that we cannot keep submissions confidential because securities legislation in certain provinces requires publication of a summary of the written comments received during the comment period. In this context, you should be aware that some information which is personal to you, such as your e-mail and address, may appear on certain CSA websites. It is important that you state on whose behalf you are making the submission.

All comments will be posted on the Ontario Securities Commission website at www.osc.gov.on.ca and on the Autorité des marchés financiers website at www.lautorite.qc.ca.

IX. Questions

Questions may be referred to:

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