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September 30, 2016

*Via Electronic Mail*

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

Re: *Public Comment on Examination of Liquidity of the Secondary Corporate Bond Markets*

Dear Mr. Eroglu:

ICI Global<sup>1</sup> appreciates the opportunity to provide comments on the consultation report issued by the International Organization of Securities Commissions (“IOSCO”) on liquidity of the secondary corporate bond markets.<sup>2</sup> Regulated funds (“funds”) are steady investors in the fixed income markets, including the corporate bond markets. As end-holders of corporate bonds, funds have a strong interest in ensuring the quality and integrity of these markets.

We commend IOSCO for conducting this analysis of liquidity in the secondary markets for corporate bonds. We believe that the corporate bond markets are undergoing significant structural transformations caused in part by regulatory reform in the aftermath of the financial crisis as well as by changing economics and technology. This letter explains how our members perceive liquidity in these markets and provides some additional data that we hope will inform further study of these markets by IOSCO and national regulators. We encourage IOSCO to continue this important work as the

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<sup>1</sup> The international arm of the Investment Company Institute, ICI Global serves a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US\$19.9 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> Board, *Examination of Liquidity of the Secondary Corporate Bond Markets, Consultation Report*, International Organization of Securities Commissions (August 2016), available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD537.pdf> (“Consultation Report”).

corporate bond markets continue to evolve and as new and more data become available outside the United States.

In Part I of our letter we discuss the recent significant structural changes to the US corporate bond markets. Part II describes our analysis, which is consistent with IOSCO's findings that commonly-used metrics show a mixed picture of liquidity of the US corporate bond markets. In Part III, we present data on the nature and extent of funds' participation in the US corporate bond markets. Part IV supports regulators obtaining accurate, comprehensive, and usable data about the corporate bond markets.

## **I. US Corporate Bond Markets Have Undergone Meaningful Structural Changes**

Traditionally, most trading in the US corporate bond markets has been over-the-counter, either between a dealer and a customer or between two dealers. This trading generally occurred over the telephone or through electronic systems that allow a customer to negotiate or trade with particular dealers. Often, dealers traded with their customers on a principal basis, using their capital to carry a large inventory of bonds on their books.

After the financial crisis and the ensuing regulatory reform, the role of dealers in these markets has changed with dealers reducing inventory and acting more often in an agency capacity for their customers. A number of factors may explain why dealers have chosen to reduce their holdings of corporate bonds, including the imposition of new regulatory requirements that limit the ability of banks to use their balance sheets to engage in market making activities and increased costs associated with holding corporate debt in inventory. Given the central role that dealers have played in corporate bond markets, it is not surprising that many participants that have become accustomed to dealers' providing liquidity in a principal capacity now must navigate their way through the new and unfamiliar environment. We agree with IOSCO, however, that the shifting landscape does not necessarily mean that there is a lack of liquidity in the corporate bond markets, particularly in the United States.

We provide below some additional data on the US corporate bond markets that signal significant changes in the market structure for corporate bonds. We caution about extrapolating findings from the US corporate bond markets to other global markets. As IOSCO notes, data are very limited outside of the United States. We expect that after implementation of the Markets in Financial Instruments Directive ("MIFID") II in 2018, there should be substantially more data available for IOSCO to conduct more granular analyses of the European corporate bond markets. IOSCO suggests that this Consultation Report will be the first of a series of reports on corporate bond markets for IOSCO, and we strongly support IOSCO's continued efforts in this area.

## **II. Our Research Is Consistent with IOSCO's View of the US Corporate Bond Markets**

### **A. Commonly-Used Metrics Show a Mixed Picture of Liquidity in the US Corporate Bond Markets**

The Consultation Report examines various liquidity metrics to assess the liquidity of the secondary corporate bond markets. We support this holistic approach to studying liquidity because

market participants value different liquidity metrics. An examination of numerous indicia of liquidity should be more reliable than a study of any single metric and should result in a more nuanced understanding of corporate bond market liquidity. The data and analyses presented by IOSCO appear to show mixed evidence of the status of liquidity in the corporate bond markets.<sup>3</sup> Some metrics, such as trade volume, indicate that liquidity has increased in recent years, while others, such as turnover ratio, suggest a modest decrease in liquidity. Our data generally comport with these findings.

For example, Figure 1 plots dealer inventories and trading volumes of US investment-grade corporate bonds (top panel) and US high-yield corporate bonds (bottom panel) from July 2, 2014 through September 14, 2016.<sup>4</sup> Starting in the first quarter of 2015, dealer holdings of investment-grade bonds began trending down without a discernible negative impact on trading volume.<sup>5</sup> In many weeks during the decline in dealer's inventories, average daily trading volume in investment-grade bonds remained stable or even increased. The pattern for US high-yield bonds is similar. Dealer inventories in high-yield bonds started declining in the fourth quarter of 2014, yet average daily trading volume remained steady and recently appears to have increased somewhat. Put differently, market participants today trade as much if not more US investment-grade and US high-yield bonds on a daily basis than when dealers maintained bigger inventories of these products.

Although investment-grade and high-yield trading volume in the United States has remained stable, turnover (the percent of a bond issue that trades on a given day) appears to have declined. As noted in a recent research report from the Office of the Chief Economist at FINRA, median turnover among the 1,000 most active bonds has fallen from a high of 1.8 percent in 2005 to about 1 percent in 2015, suggesting that it now takes about 100 days to trade a par volume equal to the issue size.<sup>6</sup> The decline in turnover may be explained, in part, by strong primary market bond issuance over the past several years. Newly issued bonds (within 90 days of the issue date) trade more than seasoned bonds. Since 2011, newly issued bonds accounted for an average of 45 percent of the volume in the most actively traded portion of the secondary market.<sup>7</sup>

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<sup>3</sup> See Consultation Report at 22.

<sup>4</sup> Figure 1 starts in July 2014 because aggregate trading data for investment-grade and high-yield bonds issued pursuant to Rule 144A of the Securities Act of 1933 are available from the Financial Industry Regulatory Authority's ("FINRA") Trade Reporting and Compliance Engine ("TRACE") system from July 2014 forward. Rule 144A permits resales of restricted corporate debt securities to large institutions called qualified institutional buyers.

<sup>5</sup> There is a normal seasonal decline in trading volume over the year-end holidays.

<sup>6</sup> FINRA, *Analysis of Corporate Bond Liquidity*, Research Note (December 2015), available at [https://www.finra.org/sites/default/files/OCE\\_researchnote\\_liquidity\\_2015\\_12.pdf](https://www.finra.org/sites/default/files/OCE_researchnote_liquidity_2015_12.pdf), at 3.

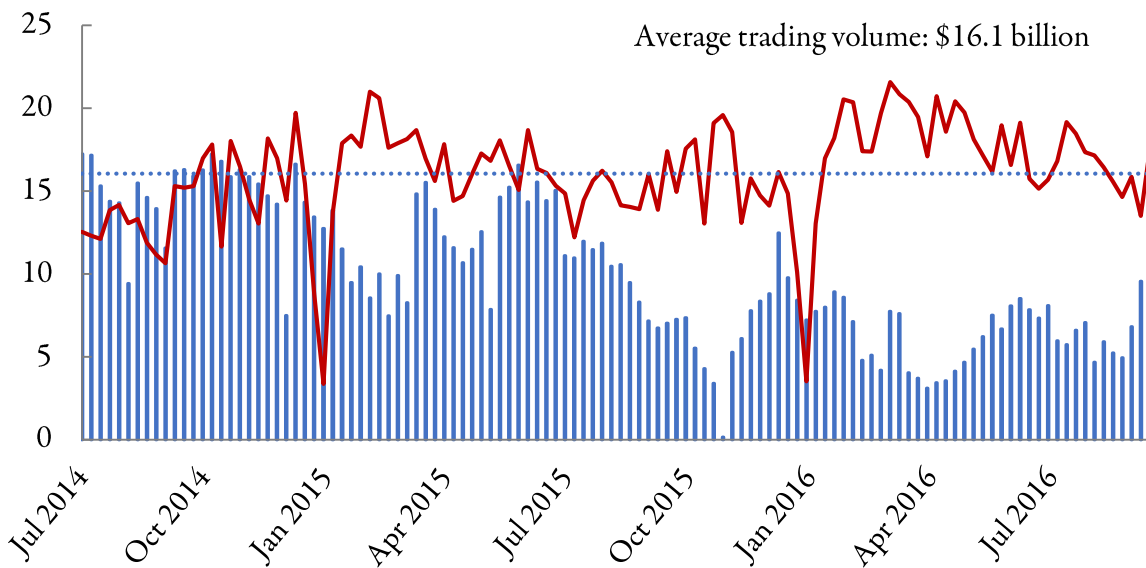
<sup>7</sup> *Id.*

**Figure 1: Primary Dealers' Inventory of Corporate Bonds Fell but Trading Volumes Remained Stable**

*Billions of dollar; average daily net position and trading volume; weeks-ending Wednesday July 2, 2014–September 14, 2016*

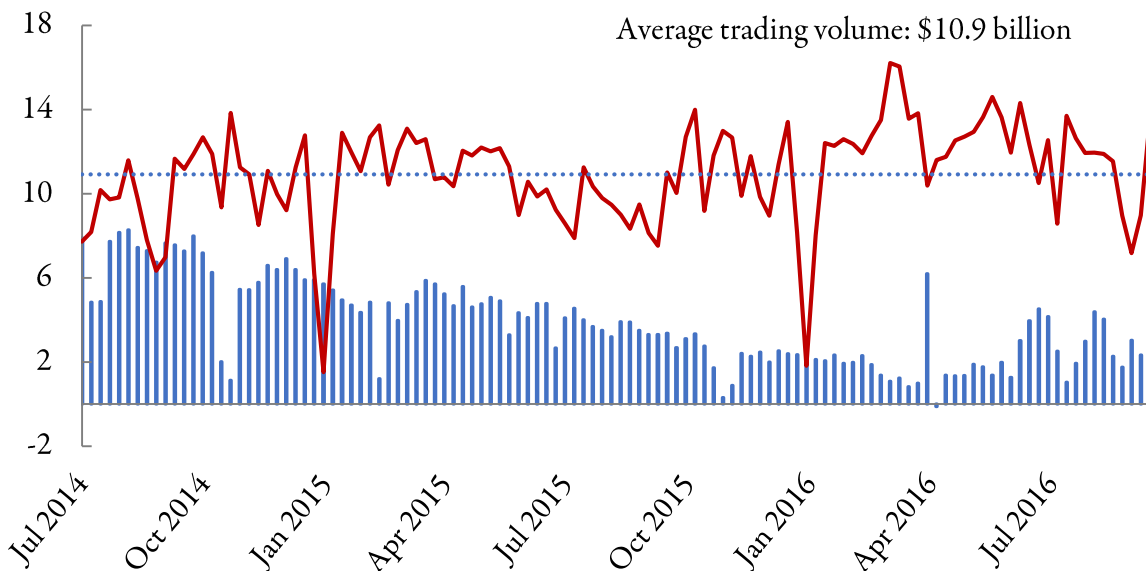
Investment grade corporate bonds

■ Net positions — Transactions



High-yield corporate bonds

■ Net positions — Transactions

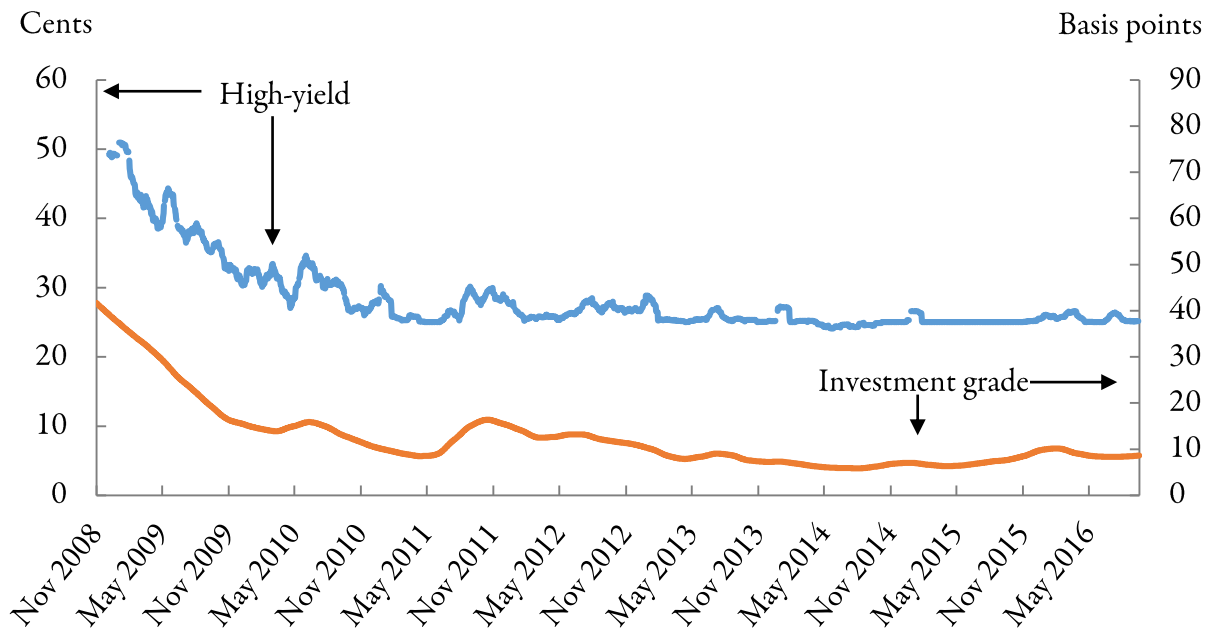


Note: Includes data on 144A bonds which only are available from July 2014 forward.  
 Sources: Federal Reserve Bank of New York and FINRA TRACE

Bid-ask spreads serve as another measure of corporate bond market liquidity. If reduced dealer inventories of corporate bonds were straining liquidity in the corporate bond markets, we would expect bid-ask spreads for these securities to widen. Figure 2, however, shows that bid-ask spreads have declined for both investment grade and high-yield corporate bonds even as dealer inventories have fallen, suggesting that liquidity in these markets has not diminished significantly.

**Figure 2: Bid-Ask Spreads Rose Modestly During the High-Yield Bond Market Decline**

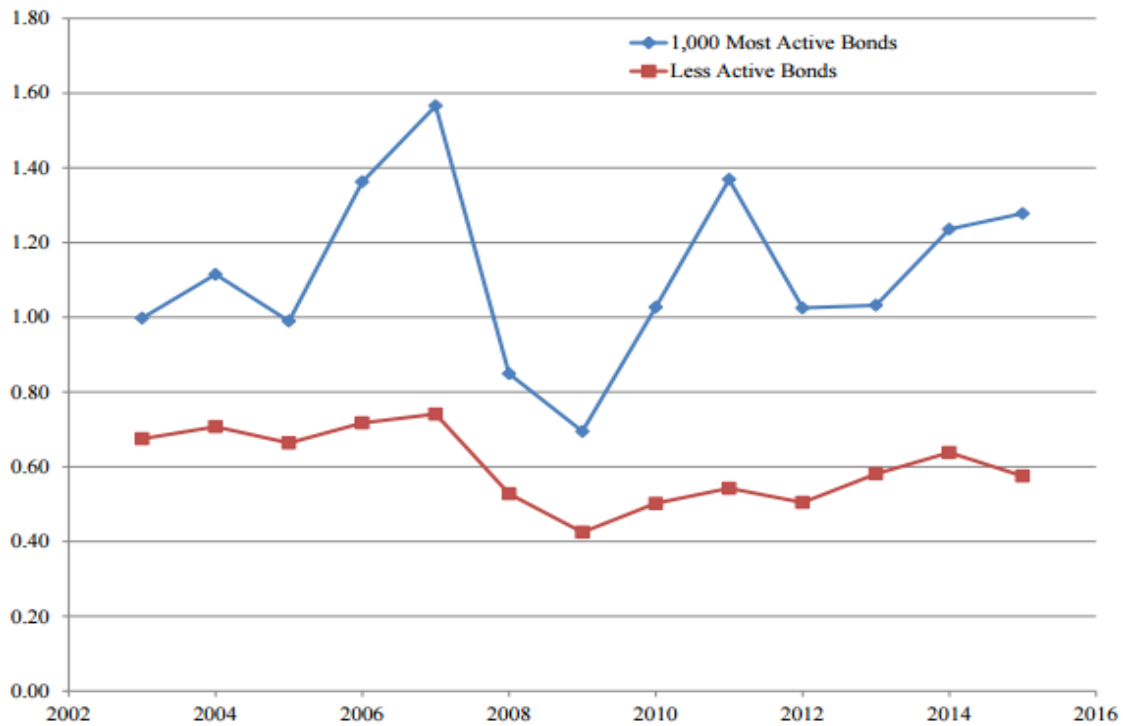
*Daily, November 3, 2008–September 19, 2016*



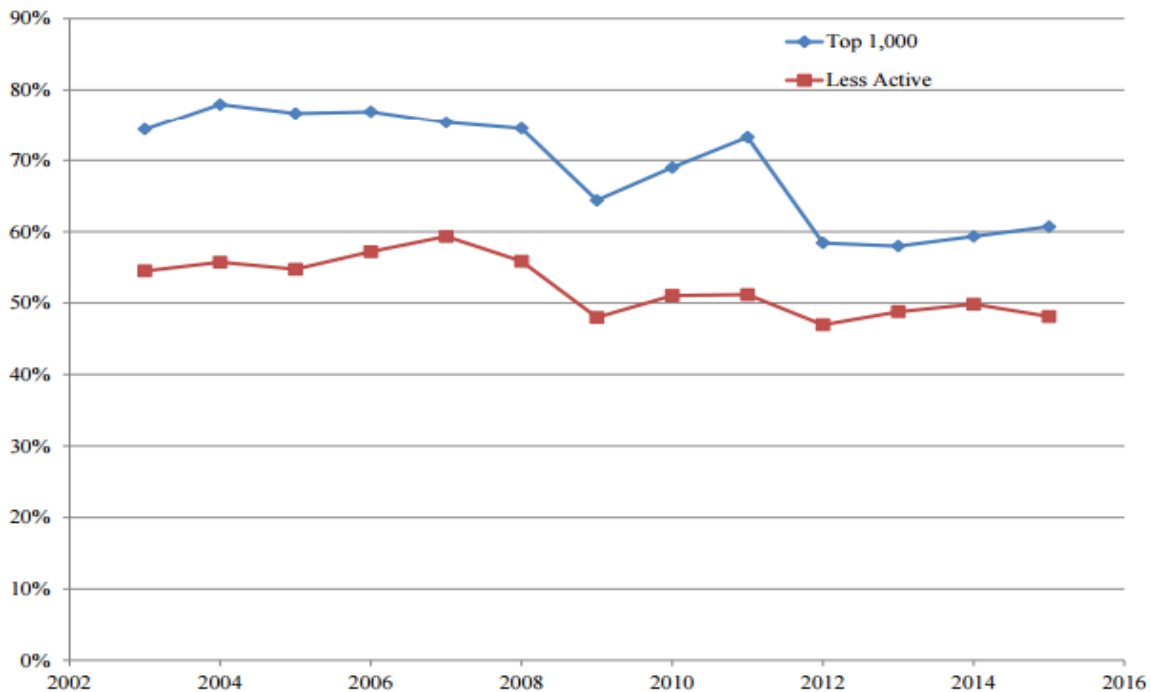
Source: MarketAxess

Other measures, however, suggest potentially important changes in the US bond markets. According to the FINRA report, market participants appear to be doing more trades in smaller size. Figure 3 (reproduced from the FINRA report) shows average trade size of the most active bonds and less active bonds from 2003 to 2015. For the 1,000 most active bonds, the FINRA study found that average trade size peaked at nearly \$1.6 million in 2007 before declining precipitously to below \$800,000 in 2009. While average trade size recently has been higher than the low seen in 2009, it remains below the level reached in 2007. For less active bonds, average trade size in 2015 was about \$600,000 compared with nearly \$800,000 in 2007. Figure 4 (also reproduced from the FINRA report) shows the proportion of total bond trading transacted as blocks (trades of \$5 million or more) from 2003 to 2015. For the 1,000 most active bonds, about 60 percent of total volume was traded as blocks in 2015, down from close to 75 percent in 2007. The share of block trading in less active bonds also has declined—from 60 percent in 2007 to roughly 50 percent in 2015. These data are consistent with viewpoints expressed by some market participants that it requires more time and trades to transact in larger sizes in the US bond market.

**Figure 3: Average Trade Size Is Smaller**  
*Millions of dollars; annual, 2003–2015\**



**Figure 4: Proportion of Volume in Block Trades Has Declined**  
*Percent; annual, 2003–2015\**



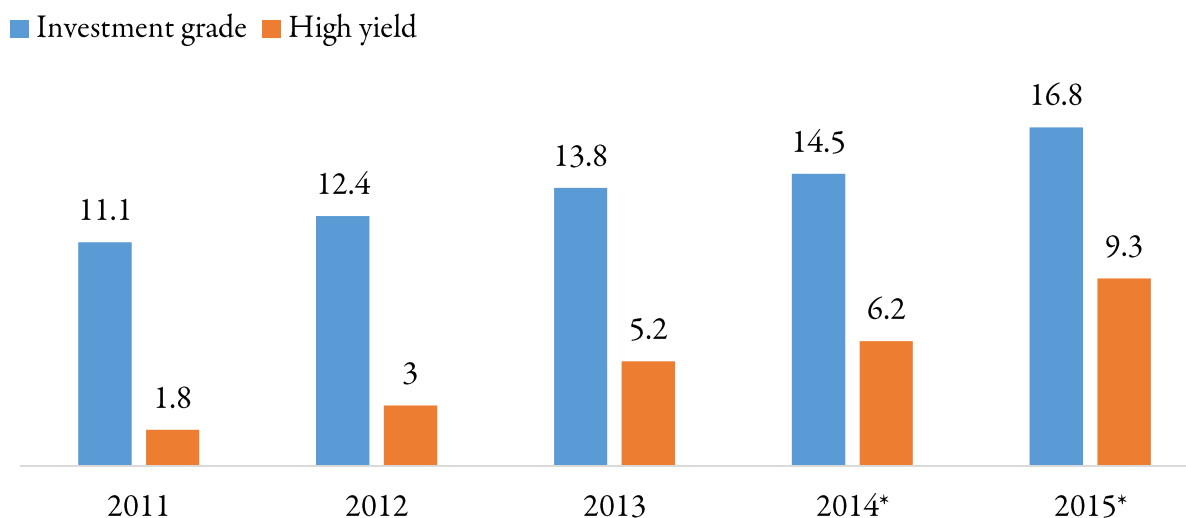
\*As of September 2015  
 Source: FINRA, "Analysis of Corporate Bond Liquidity" (December 2015)

## B. Trading in the US Corporate Bond Markets Is Evolving in the New Market Environment

After reviewing the liquidity profile of the corporate bond market globally, IOSCO suggests that “the nature of trading may be changing alongside shifts in participant behavior and market structure.”<sup>8</sup> Data from the US corporate bond market, and our members’ experience in this market indicate that the nature of trading is indeed changing as new technology has introduced trading protocols that did not exist in fixed income markets even a few years ago. These new technologies and innovations provide market participants with additional means to trade corporate bonds and enhance the ability of market participants to adapt to dealers’ changing role in corporate bond markets.

For example, although comparatively little trading occurs on exchanges or other organized venues, this aspect of market structure has changed somewhat with the rise of certain alternative trading systems (“ATS”) that facilitate corporate bond transactions, including some systems that offer all-to-all trading functionality, allowing end-holders (such as funds) to trade with other end-holders. ATSs are an increasingly important and growing source of liquidity for the bond markets. As shown in Figure 5, the share of trading in US high-grade and high-yield corporate bonds that is conducted through MarketAxess, which is one of the largest corporate bond ATSs to offer an all-to-all trading platform, has been steadily increasing over the past five years. New market participants and infrastructures likely will continue to alter the structure of the bond markets and the trading of corporate bonds to compensate for dealers’ reluctance to hold bond inventory.

**Figure 5: MarketAxess’ Share of Trading in US High-Grade and High-Yield Bonds**  
*Percent; annual, 2011–2015*



\*Adjusted by MarketAxess to eliminate the increased reporting of affiliated back-to-back trades to FINRA by certain broker-dealers that occurred from April 2014 through October 2015 and the inclusion of 144A bonds in reported TRACE volumes beginning on July 1, 2014.

Source: MarketAxess

<sup>8</sup> See Consultation Report at 22.

### **III. Policymakers Should Consider the Data on the Role of Funds in the US Corporate Bond Markets**

In examining the participants in the corporate bond markets, the Consultation Report observes that institutions, such as funds and their asset managers, play a dominant role in the corporate bond markets, while retail investors have a much more limited role.<sup>9</sup> Moreover, IOSCO notes that in several jurisdictions, one “key emerging theme” is the increasing participation of retail investors in the corporate bond market indirectly through mutual funds and ETF products, which have grown substantially over the last decade. We believe this assertion relies on incorrect data.

We believe that the role of funds in the US corporate bond markets must be placed in proper context, one that reflects the actual size of fund holdings of US corporate bonds and the nature of fund participation in these markets.<sup>10</sup> We urge regulators to develop an accurate and complete picture of the extent and behavior of funds in the corporate bond markets, particularly if regulators intend to undertake any future policy or regulatory initiatives in this area. Basing regulatory reform on incorrect data will lead to unintended consequences that could frustrate the goals of policymakers and disrupt markets for no regulatory purpose.

Specifically, regulators should take note of corrected data that shows much more modest mutual fund holdings of US corporate debt than had been previously reported. We also present data to help regulators understand how mutual funds participate in the corporate bond markets during volatile periods. The data show that mutual funds transact on both sides of the market, even during bond market sell-offs and periods of volatility. Finally, data show that exchange-traded funds can be a source of liquidity for the bond markets.

#### **A. Mutual Fund Holdings of US Corporate Bonds are Smaller Than Previously Reported**

A number of regulators and international financial institutions have recently stated that US mutual funds share of the US corporate bond market has been rising rapidly and now stands at nearly a quarter of the market. Revised data published by the Federal Reserve show, however, that mutual funds’ share of the corporate bond market is much smaller than previously reported and has been essentially flat since 2012. This new data corrects previously reported data that had been used to support hypotheses that bond mutual funds pose systemic risks.<sup>11</sup> Figure 6 compares data published by the Federal Reserve in June 2016 with data that it had previously published in March 2016.

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<sup>9</sup> See Consultation Report at 13-15.

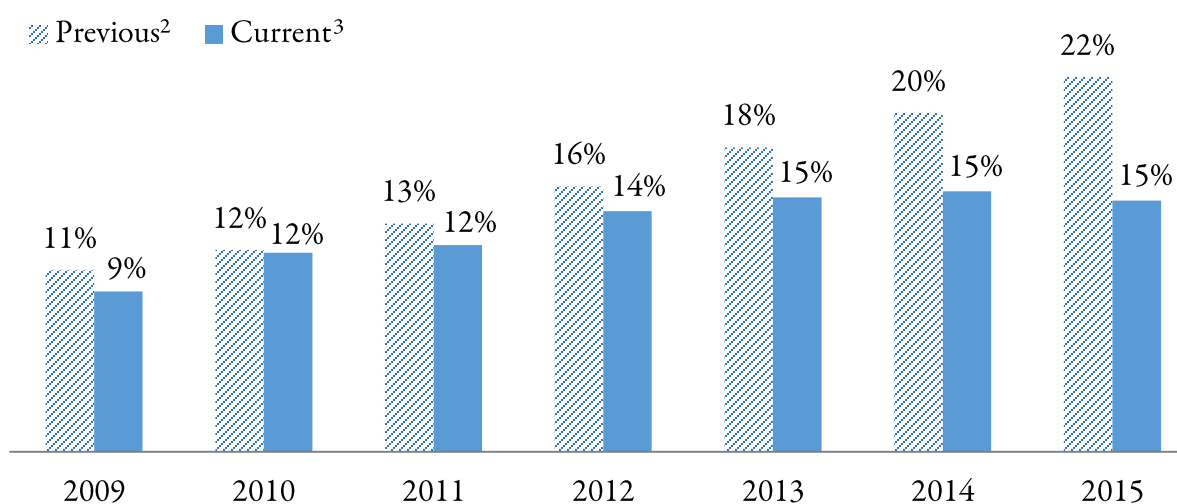
<sup>10</sup> In this section, we examine mutual funds and exchange-traded funds separately as regulators have expressed different concerns about these products.

<sup>11</sup> For example, in its recent [Update on the Review of Asset Management Product and Activities](#), the Financial Stability Oversight Council (“FSOC”) repeated its contention that bond mutual funds could be subject to destabilizing “runs” that would harm broader markets and the financial system. Further, FSOC said, “the magnitude of these potential risks, and



The revised data provide a more accurate picture of the extent of mutual funds' participation in the corporate bond market. Mutual funds' share of the market—though increasing from 9 percent in 2009 to 15 percent in 2015 (shown as the solid blue bars)—has remained virtually unchanged since 2012. Prior statistics indicated that mutual funds' share of the US corporate bond market had doubled to 22 percent over the six-year period ending in 2015 (shown as blue hashed bars). These statistics, however, were based on a methodology that substantially overstated mutual funds' corporate bond holdings.<sup>12</sup> This revision dramatically alters the picture of mutual funds' share of the US corporate bond market and regulators should use this updated data to assess the role of mutual funds in this market.

**Figure 6: Revised Data Show Mutual Funds' Share of Corporate Bond Market<sup>1</sup> Fairly Constant Percent; year-end, 2009–2015**



<sup>1</sup>Bonds issued by domestic corporations and foreign bonds held by U.S. residents.

<sup>2</sup>Calculated from Table L.213 (line 34/line 1, expressed as percent) in the Flow of Funds Accounts, Z.1 Financial Accounts of the United States, published by the Federal Reserve Board in March 2016.

<sup>3</sup>Calculated from Table L.213 (line 34/line 1, expressed as percent) in the Flow of Funds Accounts, Z.1 Financial Accounts of the United States, published by the Federal Reserve Board in June 2016.

Source: Federal Reserve Board

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hence both the likelihood and impact of any forced selling by mutual funds on broader markets, likely increases as mutual funds' overall market share of less-liquid assets increases.”

<sup>12</sup> For example, the statistical process used to estimate mutual fund holdings failed to remove bonds that had matured and were no longer held on mutual funds books.

## **B. Funds and Their Investors Are Stable Investors in Corporate Bond Markets**

Various commentators and regulators have expressed concerns about the state of liquidity in the corporate bond market and the potential for bond fund flows to be destabilizing. They have prophesied that a sudden rise in interest rates or other event in the credit markets could cause bond fund shareholders to sell their shares *en masse*, forcing these funds to liquidate large portions of their bond portfolios. Their fear is that these “forced” sales by bond funds will put additional strain on bond markets that they believe may have less capacity now to facilitate transactions, thereby precipitating further declines in bond prices.<sup>13</sup> The data, however, demonstrate that predictions of mass bond fund redemptions have not materialized in periods of market stress. To the contrary, many investors purchase shares of bond funds and bond funds often buy bonds during volatile markets. In this section, we present data from the US corporate bond markets to illustrate how bond funds behave during periods of market stress.<sup>14</sup>

### **1. Mutual Fund Investors Take a Long View Even During Times of Stress**

One of the most enduring and salient facts about investors in US bond mutual funds is that—on net and in aggregate—they redeem only modestly, even during severe economic shocks. Figure 7 shows the flows to and from US corporate bond mutual funds (combining investment grade and high-yield funds) for each month since 2006. The dotted black lines indicate, roughly speaking, the bond mutual funds that within a given month had close to the highest net inflows and the largest net outflows relative to their assets (technically, the bond mutual funds at the 90<sup>th</sup> and 10<sup>th</sup> percentiles when ranked by net flows). In any given month, some bond mutual funds experience net inflows and others have net outflows. For example, in December 2015 when the US high-yield market was under stress, some bond mutual funds saw heavy net outflows, while others saw equally strong net inflows. Net flows to individual bond mutual funds can vary widely, as shown by the vertical distance between the two dotted black lines. The center red line is the asset-weighted average of the net flows to all US corporate bond mutual funds in any given month and shows that net inflows and outflows to individual US corporate bond mutual funds within a given month tend to balance out, on net, resulting in modest aggregate flows. In fact, aggregate net flows never exceeded 5 percent (either positive or negative) of the assets of US regulated corporate bond mutual funds in any month over the past ten years.

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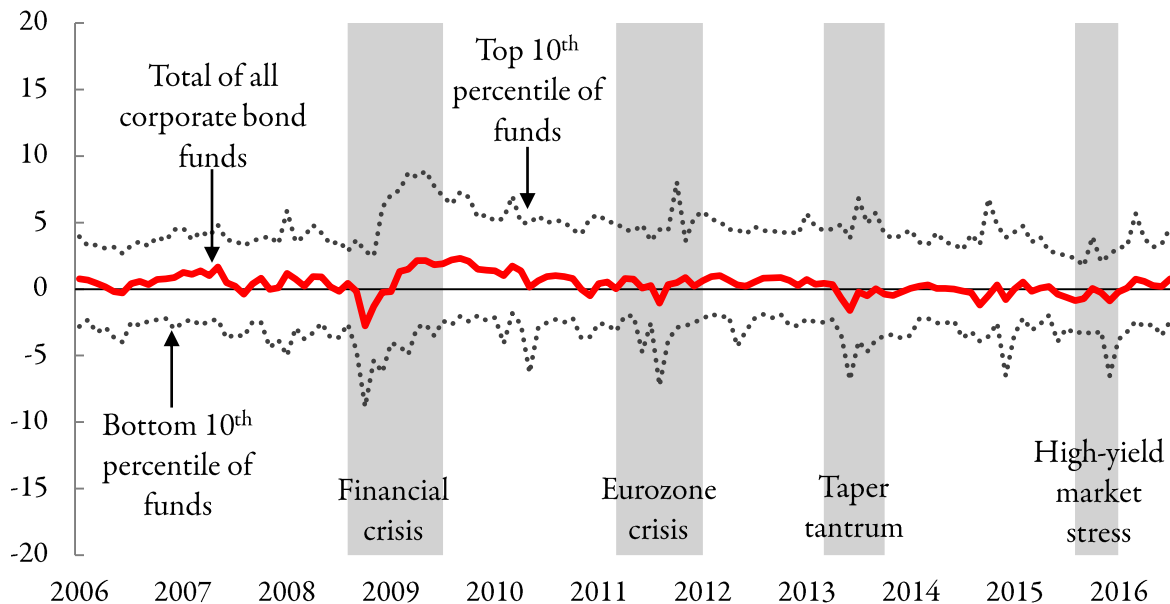
<sup>13</sup> See, e.g., Office of Financial Research, *Asset Management and Financial Stability* (Sept. 2013) at 9, 12-15, available at [https://www.treasury.gov/initiatives/ofr/research/Documents/OFR\\_AMFS\\_FINAL.pdf](https://www.treasury.gov/initiatives/ofr/research/Documents/OFR_AMFS_FINAL.pdf); Consultative Document, *Assessment Methodologies for Identifying Non-Bank Non-Insurer Global Systemically Important Financial Institutions: Proposed High-Level Framework and Specific Methodologies* (8 Jan. 2014), available at [http://www.fsb.org/wp-content/uploads/r\\_140108.pdf](http://www.fsb.org/wp-content/uploads/r_140108.pdf).

<sup>14</sup> Much of this data features the high-yield segment of the US corporate bond market. This part of the market generally is less liquid than the investment grade portion of the market, but its relative illiquidity makes it an appropriate sample for this type of analysis. The effects of mass fund redemptions on bond prices should be more pronounced in a less liquid market than they would be in a more liquid one.

Even during significant market shocks, aggregate net flows were fairly small. For example, in May and June 2013, the Fed's talk of "tapering" its monetary stimulus led to the so-called Taper Tantrum, one of the sharpest run-ups in bond yields in decades. But corporate bond mutual funds in aggregate saw net outflows of just 2.6 percent of their assets.

**Figure 7: Investors in US Regulated Bond Mutual Funds Redeem Only Moderately**

*Net flow as a percentage of assets; monthly, January 2006–July 2016*



Note: Corporate bond mutual funds include high-yield and investment grade bond mutual funds. Data exclude mutual funds with less than \$10 million in average total net assets, mutual funds that invest primarily in other mutual funds, and data for mutual funds for which a merger or liquidation occurred.

Source: Investment Company Institute

Two factors help to explain the consistency of these results across different market cycles. First, fully 95 percent of the assets in US long-term mutual funds are held by US households, not institutional investors. These investors often construct diversified investment portfolios by investing in different funds—including mutual funds and exchange-traded funds (“ETFs”)— to gain exposure to a number of asset classes and sub asset classes, and they invest in funds to accomplish their long-term financial goals, such as paying for college or enjoying a secure retirement. These shareholders have long investment horizons—perhaps 10 to 40 years—and are able to look beyond market cycles. Some also contribute consistently, month in and month out, often through automatic payroll withdrawal. Second, some investors might view a steep market decline as a buying opportunity—particularly in bond funds. As bond prices decline, yields rise, attracting new investors or encouraging current investors to buy more shares in bond funds. Fund flow data demonstrate that in times of stress, fund investors provide a two-way market and create a self-correcting dynamic rather than a destabilizing spiral.

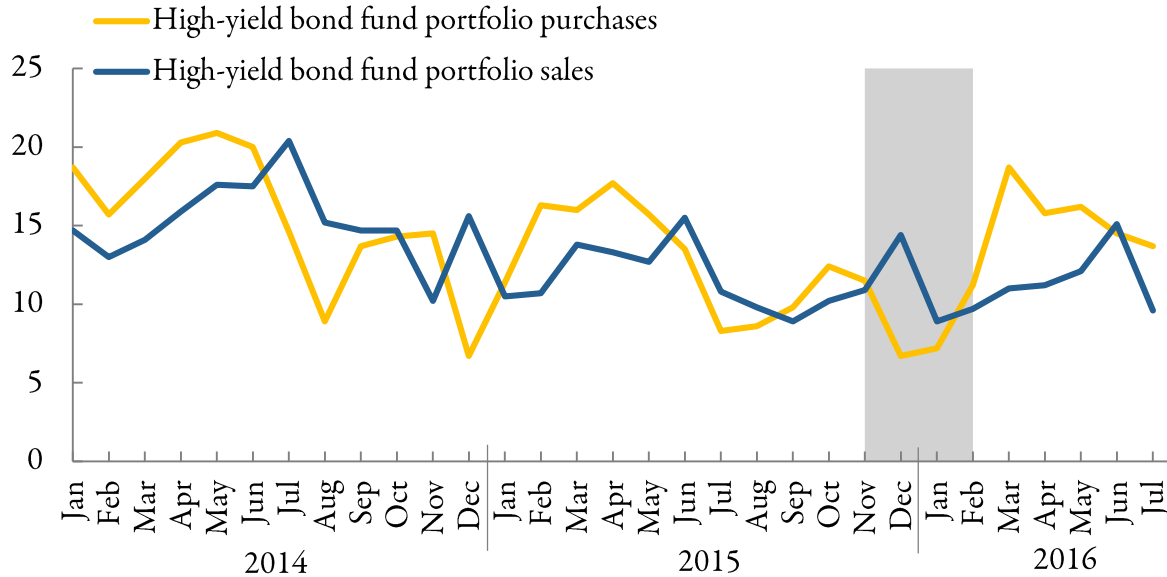
## **2. Bond Mutual Funds Continue to Buy Bonds Even in Falling Markets**

Bond mutual funds, like their shareholders, participate on both sides of the markets, even during periods of market stress. Bond mutual fund managers' portfolio management activities include robust liquidity management practices designed to allow funds to continue to purchase bonds, even during periods where they experience net outflows. Bond mutual funds regularly purchase bonds in falling markets, contradicting the common prediction of regulators and others that these funds will sell large amounts of portfolio assets to accommodate net outflows and that their sales of these assets will overwhelm the market.

Figure 8 shows that during the sell-off in the US high-yield corporate bond market in late 2015, bond mutual funds continued to buy corporate bonds. In fact, 85 percent of high-yield bond mutual funds purchased corporate bonds in December of 2015 (Figure 9). In addition, bond mutual fund purchases of high-yield bonds actually increased in January and February of 2016, even though the US high-yield bond market remained under stress, with average yields on these bonds rising to 10 percent. The cash required to purchase these new bonds came from a variety of sources, including proceeds from the sale of new mutual fund shares, interest payments, maturing bonds, existing cash, and sales of certain portfolio assets to purchase other bonds at more attractive prices. Even bond mutual funds with modest net outflows had proceeds from maturing bonds and interest income to put to work in the market, including managers of bond mutual funds that had some of the weakest performance in November and December 2015 (Figure 10).

**Figure 8: US High-Yield Bond Mutual Fund Managers Continued to Buy Corporate Bonds Even During the 2015 Sell-Off**

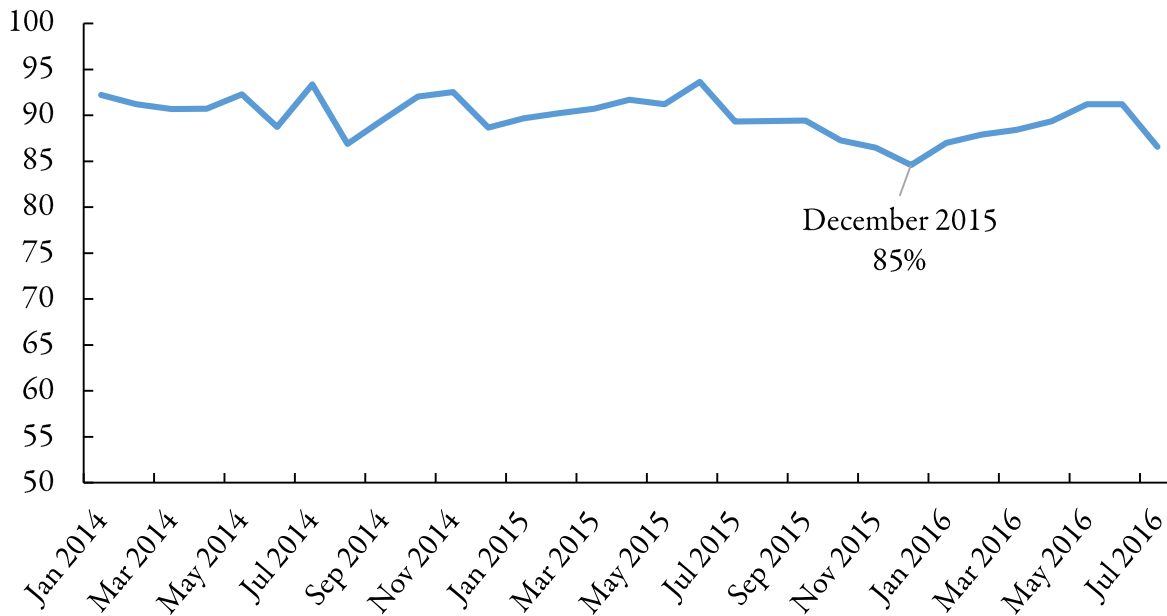
*Billions of US dollars; monthly, January 2014–July 2016*



Note: The shaded region represents November 2015 through February 2016.  
 Source: Investment Company Institute

**Figure 9: 85% of High-Yield Bond Mutual Funds Purchased Corporate Bonds in December 2015**

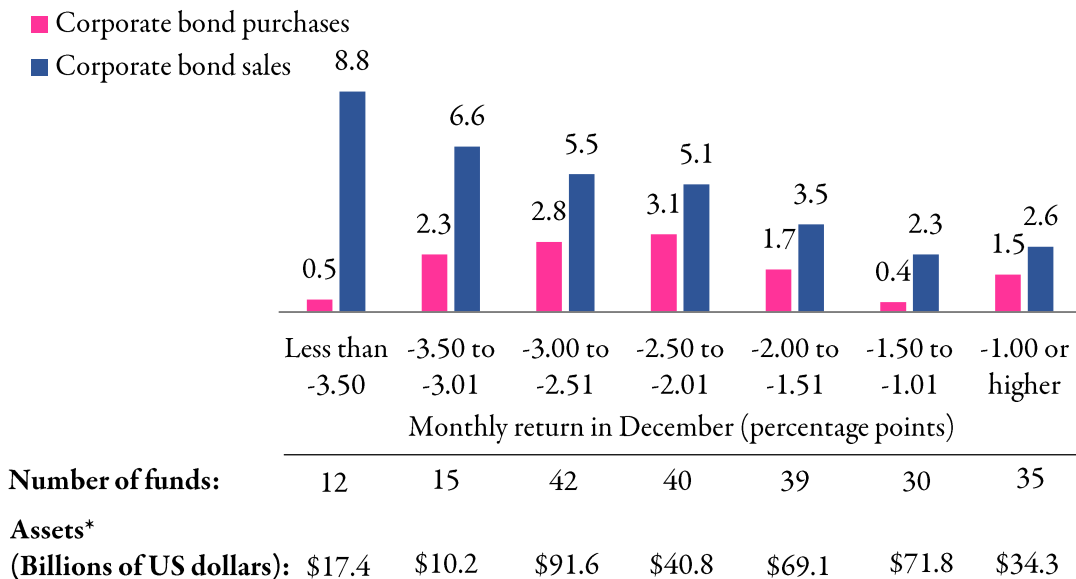
*Percent; monthly, January 2014–July 2016*



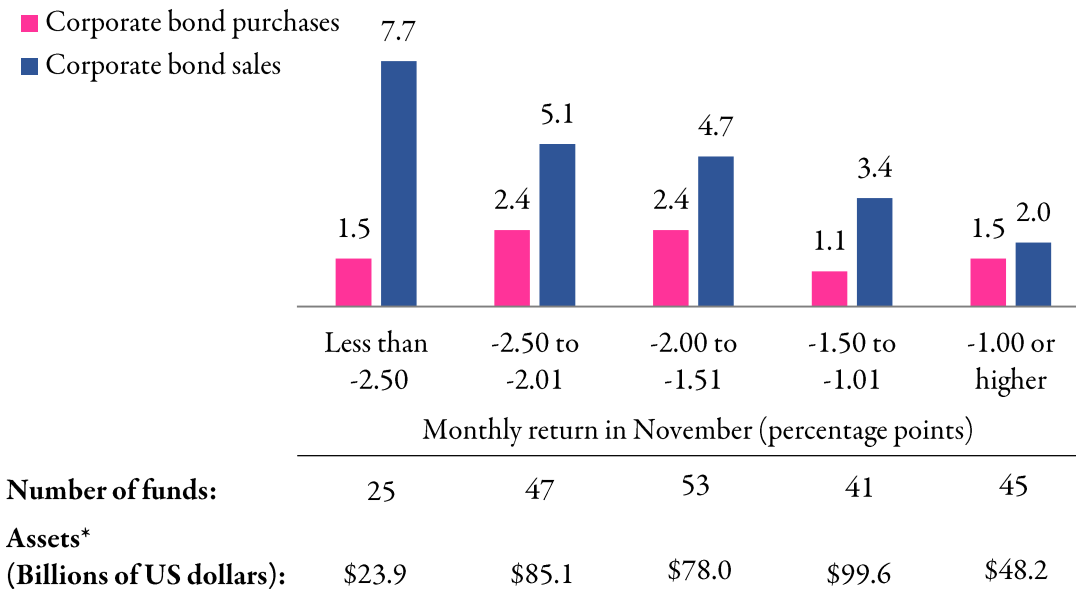
Sources: Investment Company Institute and Morningstar

**Figure 10: US High-Yield Bond Mutual Funds Both Purchased and Sold Corporate Bonds in December 2015 Regardless of Performance**

*Purchases and sales of corporate bonds as a percentage of assets\*, by December fund return*



*Purchases and sales of corporate bonds as a percentage of assets\*, by November fund return*



\*As of November 30, 2015

Source: Investment Company Institute and Morningstar

### **C. Funds Act as an Alternative Source of Liquidity for the Corporate Bond Markets, Especially During Market Stress**

As IOSCO continues to research the corporate bond markets, it should consider the role of bond funds, particularly ETFs, as a potential source of liquidity, especially during volatile periods. According to our research, during the stressed conditions in the US high yield corporate bond market in late 2015, ETFs added substantial liquidity to the market. Secondary market trading of high-yield bond ETFs relieved pressure on trading in high-yield bonds by providing a mechanism for investors to increase or reduce their exposure to this asset class without buying or selling physical bonds. These ETFs provided investors with an efficient means of transferring risk with limited impact on the bond market.<sup>15</sup>

Figure 11 shows daily secondary market volume of ETFs (the green shaded region) and daily transaction volume in high-yield bonds (the blue shaded region) from November 2 to December 23, 2015. Daily trading in high-yield bond ETFs averaged \$1.3 billion during the five weeks before December 8, while daily transaction volume in high-yield bonds averaged \$11.3 billion over the same time period. Secondary market trading of high-yield bond ETFs, during this period of relative calm, added roughly 10 percent (\$1.3 billion/\$11.3 billion) to daily liquidity in the high yield market.

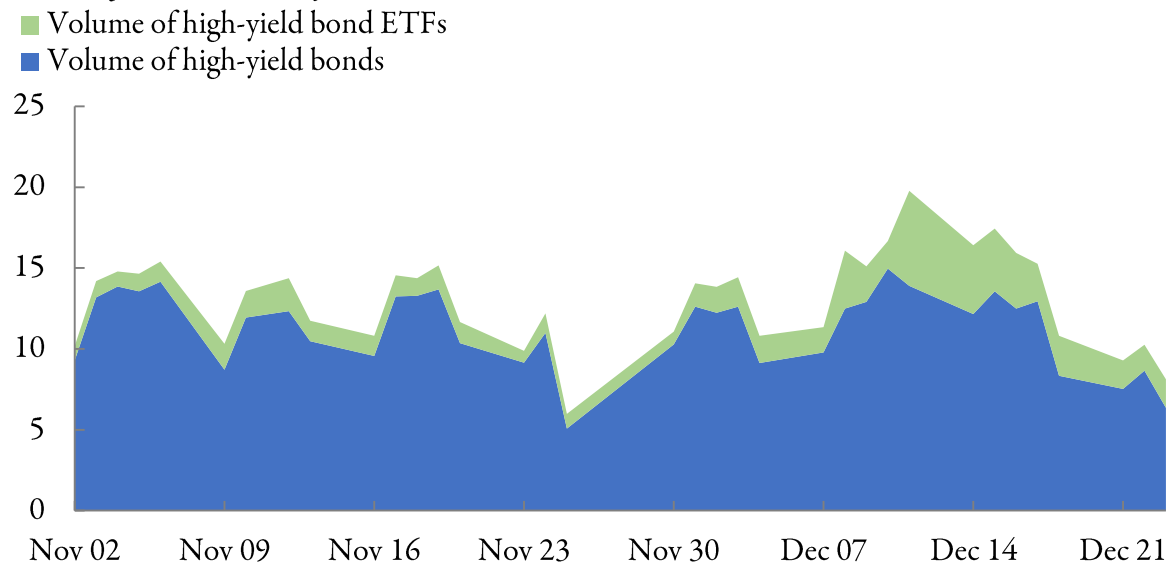
Beginning December 8, however, trading in both high-yield bonds and high-yield bond ETFs surged, as stresses emerged in the high-yield market. From December 8 – December 18, the average daily value of high-yield bond ETFs traded jumped to \$3.3 billion, while the daily transaction volume in high-yield bonds increased to \$12.6 billion. During this stressed period, secondary market trading of high-yield bond ETFs provided 26 percent (\$3.3 billion/\$12.6 billion) in daily liquidity to the high-yield market. Moreover, even in the face of declining prices, sellers of high-yield bond ETFs found willing buyers in the secondary market and ETF shares were not redeemed *en masse* back to the funds. As shown in Figure 12, daily net redemptions of high-yield bond ETFs were modest during the height of the stress in December. The largest daily net outflow—\$1 billion on December 14—accounted for only 8 percent of trading in high-yield bonds on that day.

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<sup>15</sup> For the most part, when investors buy or sell shares of a bond ETF on an exchange, only the shares change hands while the bonds within the ETF's portfolio remain untouched.

**Figure 11: Secondary Market Trading of US High-Yield Bond ETFs Added Liquidity to US High-Yield Market**

*Billions of US dollars; daily, November 2–December 23, 2015*

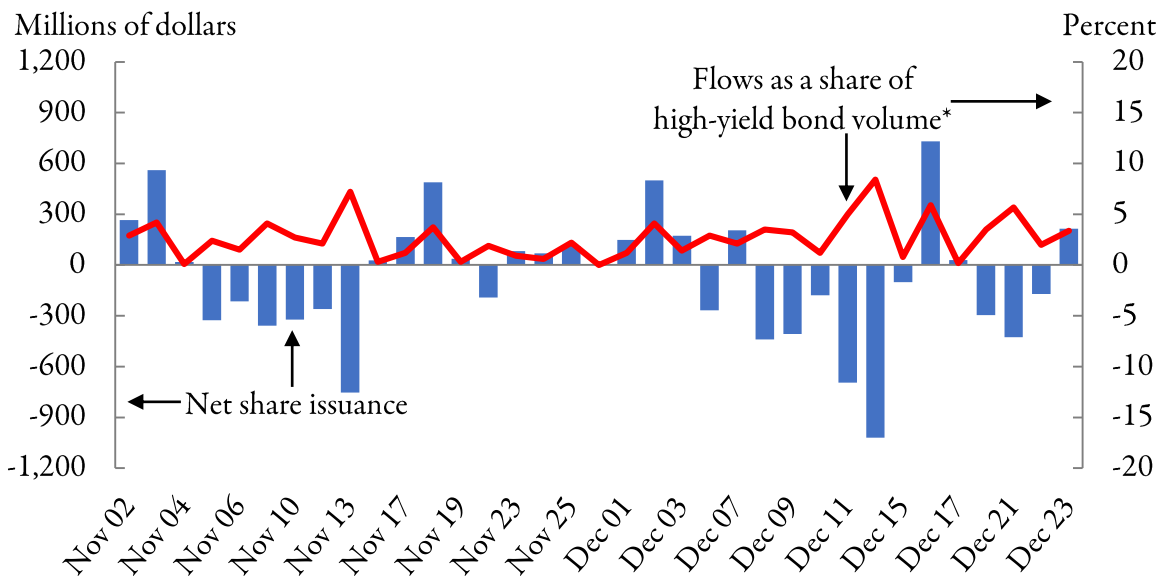


Note: Data exclude high-yield ETFs designated as floating-rate. Data also exclude Veteran's Day and the Friday after Thanksgiving.

Sources: Investment Company Institute, Bloomberg, and FINRA TRACE

**Figure 12: US High-Yield Bond ETFs' Net Flows Are a Small Share of Underlying US High-Yield Bond Volume**

*Daily, November 2–December 23, 2015*



\* Absolute value of net share issuance divided by total high-yield bond trading volume.

Note: Data exclude high-yield ETFs designated as floating-rate. Data also exclude Veteran's Day and the Friday after Thanksgiving.

Sources: Investment Company Institute and Bloomberg



#### **IV. Regulators Should Seek Access to More Complete Information to Study and Analyze the Corporate Bond Markets**

IOSCO notes that a lack of useful data concerning the secondary market for corporate bonds complicated its efforts to assess liquidity in this market. We appreciate this concern and support regulatory efforts to gather data about corporate bond markets. In the United States, regulators receive data on the corporate bond markets through the Trade Reporting and Compliance Engine (“TRACE”). US law requires reporting of nearly all transactions in corporate bonds (and certain other fixed income securities) to TRACE and the data collected from these reports allow relevant authorities to monitor trading and market conditions in the US corporate bond markets. Legal developments in Europe, namely the implementation of MiFID II, should provide EU regulators with information to analyze the corporate bond markets in Europe.

In considering the optimal design of regulatory reporting requirements, we encourage authorities to leverage existing reporting capabilities and practices as much as possible. Market participants transact in corporate bonds using various models of execution and a diverse range of venues, but virtually all trades involve a dealer on at least one side or are intermediated by a dealer or trading platform. These intermediaries are in the best position to report corporate bond transactions because of the access they have to trading data as a result of their central role in the market and of their existing systems for reporting transactions in fixed income and other markets. End-holders of corporate bonds, such as funds, typically lack infrastructure to report corporate bond transactions and, in any event, placing reporting obligations on funds and other investors would not enhance the scope of transactions visible to regulators or improve the quality of the data that is available.

Prior to implementing new reporting requirements, regulators should address how they intend to maintain the security of the information collected and the extent to which such information will be made accessible to third parties. Cyber criminals will have every incentive to target repositories containing immense volumes of presently unavailable data on corporate bond markets. A data breach could compromise critical business information, including, potentially, position and trading information for some funds. Any regulator that seeks to adopt a reporting regime for corporate bond markets must ensure that it is prepared to protect this sensitive data.<sup>16</sup> IOSCO can play a helpful role in this process by providing a forum for regulators to share information about reporting practices that work well in particular jurisdictions and to promote the development of consistent practices globally.

Going beyond regulatory reporting, however, and introducing public dissemination or other market structure changes to the corporate bond markets should not be undertaken without analysis of data over a substantial period of time and varied market conditions. As IOSCO notes, transparency could have an effect on market liquidity.<sup>17</sup> Any proposed “reforms” should be designed to address

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<sup>16</sup> At a minimum, the regulator should retain an expert third-party to test and verify the capabilities of any data repository that will hold transaction information. The regulator also should make sure that any third-parties (e.g., other regulatory bodies) that will have access to the data have taken appropriate steps to ensure the confidentiality of the data.

<sup>17</sup> See Consultation Report at 48.

particular market failures that are empirically demonstrated. Proposing market structure changes in the absence of data supporting a market failure could risk destabilizing the market or stifling innovation—such as the growth of all-to-all trading—to the detriment of market participants.

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We appreciate the opportunity to provide feedback on the Consultation Report. If you have any questions on our letter, please feel free to contact the undersigned, Brian Reid, Chief Economist, at (202) 326-5917, Jennifer Choi, Associate General Counsel, at (202) 326-5876, or George Gilbert, Counsel, at (202) 326-5810.

Sincerely,

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