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VIA EMAIL

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

August 29, 2018

Dear Sirs/Mesdames,

Re: CSA Staff Notice and Request For Comment 21-323 *Proposal for Mandatory Post-Trade Transparency of Trades in Government Debt Securities, Expanded Transparency of Trades in Corporate Debt Securities* and Proposed Amendments to National Instrument 21-101 *Marketplace Operations* and Related Companion Policy

We are writing in respect of CSA Staff Notice and Request For Comment 21-323 *Proposal for Mandatory Post-Trade Transparency of Trades in Government Debt Securities, Expanded Transparency of Trades in Corporate Debt Securities* and Proposed Amendments to National Instrument 21-101 *Marketplace Operations* and Related Companion Policy (collectively, the "2018 Proposal"). Thank you for the opportunity to submit comments.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco, Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide get the most out of life. As of July 31, 2018, Invesco and its operating subsidiaries had assets under management of approximately USD 988 billion. Invesco operates in more than 20 countries in North America, Europe and Asia.

Fixed income investing is a significant portion of Invesco's business, both globally and in Canada, and as such, we are passionate about transparency in debt markets. In our opinion, at present, Canadian debt markets are opaque and this has been harmful to us and our investors, as well as virtually every other buy-side investor, whether or not they are aware of that fact. In 2014, the Ontario Securities Commission ("OSC") issued *The Canadian Fixed Income Market 2014* (the "OSC Fixed Income Paper")[1], which reviewed the state of Canadian fixed income markets with a view to further regulation in this area. That paper provided, in our view, an excellent description of the Canadian fixed income market and the underlying issues associated with that market. It discussed the fixed income market's structure, purpose,

[1] *The Canadian Fixed Income Market 2014*, Ontario Securities Commission.

and scope, but also its shortfalls. Following publication of the OSC Fixed Income Paper we met with senior staff of the OSC's Market Regulation Branch to discuss the concerns raised in the OSC Fixed Income Paper, and to relate our own experience from the buy-side. We found OSC Staff to be knowledgeable about the issue and prepared to consider a wide array of regulatory approaches.

The Canadian Securities Administrators ("CSA") then issued CSA Staff Notice and Request for Comment 21-315 *Next Steps in Regulation and Transparency of the Fixed Income Market* (the "2015 Proposal"). While some progress was made between the OSC Fixed Income Paper and the 2015 Proposal, we expressed our concern in a comment letter on the 2015 Proposal[2] that while going from a state of opaqueness to dissemination of trade information two days following the trade was certainly an improvement, it did nothing to address the underlying issues raised by buy-side participants or as discussed in the OSC Fixed Income Paper. The 2018 Proposal improves on the 2015 Proposal by proposing to disseminate trade information one day after the trade. In our opinion, this still falls short of addressing the concerns previously raised.

OSC Fixed Income Paper

While the OSC Fixed Income Paper is not currently up for comment, it is a foundational piece for the 2018 Proposal and, therefore, it may be instructive to review the OSC Fixed Income Paper and assess how its findings are reflected in the 2018 Proposal.

In the OSC Fixed Income Paper the assertion is made that the Canadian corporate bond market is less than half the size of the Canadian equity market despite there being four times as much corporate debt than equity issued annually.[3] One interesting difference between the debt and equity markets is that the latter has broad participation, encompassing both retail and institutional investors, whereas the former is comprised predominantly of institutional investors. Citing the Bank of Canada in 2004, the OSC Fixed Income Paper acknowledges that "retail trading volume is relatively small in fixed income markets, retail investors are relatively less informed than institutional investors."[4]

It seems clear that the lack of retail participation in Canadian fixed income markets is an important factor relating to liquidity. This lack of retail participation is to a large degree attributable to information asymmetry, both in terms of the difficulty of obtaining information on specific issues and, also, in terms of obtaining trade information. It is also attributed to higher costs associated with retail investing. For example, according to the OSC Fixed Income Paper, institutional investors pay 20 times less than retail investors to trade in bonds.[5] Is it any wonder, therefore, that retail investors do not participate in this market? We submit that this magnitude of difference is evidence of a distorted market, and therefore, resolving the information asymmetry and eradicating the perception of unfairness in Canadian fixed income markets is vital to resolving, in part, the issues raised by the OSC Fixed Income Paper. While each investor is and should be responsible for their own research on the merits of particular fixed income securities, a regulatory response can and should address the information asymmetry in information relating to trades.

For the reasons discussed below, the 2018 Proposal does nothing to address this aspect of information asymmetry for retail, and all buy-side, investors. We therefore will be urging the CSA to take more meaningful steps to solve the problems raised in the OSC Fixed Income Paper. But first, it is important to explore the issues around information asymmetry for this particular market further.

In discussing the secondary market, the OSC states in the OSC Fixed Income Paper that "the rule-based approach to order matching in equity markets is meant to ensure that investors receive the

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[2] http://www.osc.gov.on.ca/documents/en/Securities-Category2-Comments/com_20151102_21-315_invesco-canada-ltd.pdf (the "2015 Comment Letter")
[3] OSC Fixed Income Paper, *infra.,* p.14
[4] *Ibid.*, p.17
[5] *Ibid.*, p.20

best price available on a market, whereas, in the fixed income market, orders are executed on a best efforts basis to obtain a fair price."[6] The problem with this formulation is that only one party to the transaction has the information to determine if prices are, indeed, fair. That said, the OSC cautions against complete transparency: "Complete transparency can deter market makers from participating for a number of reasons. One concern is that buyers or sellers can gain bargaining power over market makers, this could allow them to determine a market maker's position and cost information, **which drastically reduces the market maker's potential profit.** The other concern is the free-rider effect: in a negotiated market, the initial search costs are high, but the marginal cost of disseminating and using this information is (or close to) zero. Full transparency can reduce bid-ask spreads but also reduces the incentive for market makers to participate because they rely on these spreads to compensate for their search efforts."[7] (emphasis added) This passage in the OSC Fixed Income Paper surprised us as it implies that introducing transparency would lead to a loss of market makers which would, in effect, cripple the market. We understand this to be the position of the banking sector, including its regulators, but are surprised that the OSC did not question this assertion. We believe that both transparency and market making can co-exist and that the lure of private sector profits is a poor reason to perpetuate an unfair market.

The purpose of the *Securities Act* (Ontario) (the "Act") (and other provinces' securities legislation has similar, although not identical, purposes) is:[8]

(a) To provide protection to investors from unfair, improper or fraudulent practices;

(b) To foster fair and efficient capital markets and confidence in capital markets; and

(c) To contribute to the stability of the financial system and the reduction of systemic risk.

The current approach to fixed income trading in Canada is indeed unfair, results in retail investors paying significantly higher transaction costs than institutional investors, and, as we discussed in our 2015 Comment Letter, results in institutional buy-side investors sometimes obtaining unfair prices. As such, the status quo is inconsistent with the first listed purpose of the Act. Similarly, the functioning of the Canadian fixed income market is also inconsistent with the second listed purpose. Where information asymmetry exists, there simply cannot be efficient markets. Buy-side participants may have information to assess the value of a particular fixed income investment, but they are systemically denied information relating to transactions in that market and therefore cannot reasonably determine if they are paying a fair market price for their investments. An efficient market requires that investors can assess both the intrinsic value of an investment as well as a fair market price for the investment. The existing information asymmetry leads to a chill in the markets and fewer transactions than might ordinarily be the case since investors cannot know what they ought to be paying based on market activity. Consider the housing market as an example. The average sale price of a home in Toronto's secondary market is over $1 million. A buyer may be interested in a house that is listed for $2 million. But if that buyer knew that similar houses in the area recently sold for, on average, $1.5 million, they may be less willing to pay $2 million, or if they find out these facts after they bought the house, they may feel that they paid an unfair price and this will erode their confidence in the Canadian housing market. We believe that would be overall negative for the housing market and, in a similar vein, the lack of transparency is an overall negative for the fixed income market. We are not persuaded, nor have we seen any evidence to suggest, that additional transparency will cause a significant exodus of market makers from the market so as to lead to a greater oligopoly than exists today that can hinder the efficiency of the markets. Therefore, the current system must be fixed in order for the second purpose to be met.

Lastly, we are not able to assert whether the current approach to fixed income market regulation is consistent with the third listed purpose of securities regulation but we note that, if it is consistent, then it

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[6] *Ibid.*, p.21
[7] *Ibid.*, p.22
[8] *Securities Act* (Ontario), R.S.O. 1990, c.S.5, as amended by, among others, S.O. 1994, c.33, s.2; S.O. 2017, c.34, Sched. 37, s.2; s.1.1.

follows that the CSA has determined that the third purpose trumps the other two and we can find no basis in the law for such a position.

The historic lack of a proper secondary marketplace for trading fixed income securities in Canada is certainly a major part of the problem. "While participants can trade both government and corporate bonds on Candeal, in practice, they only trade government bonds. Between 2011 and 2013, over 85% of ATS trades were executed on Candeal, with the remainder executed on CBID."[9] The CSA has attempted to rectify this with the concept of the appointment of information processors[10] who disseminate trade information to the public. This effort has failed as an information processor has never been appointed for government securities.[11] The 2018 Proposal does address this issue directly and we agree with the CSA decision to appoint the Investment Industry Regulatory Organization of Canada ("IIROC") to this role.

In canvassing experience elsewhere in the world, the OSC Fixed Income Paper primarily turns to the U.S. and its experience with the TRACE system, which showed that "post-trade transparency lowered transaction costs in the fixed income market without decreasing liquidity."[12] Importantly, under TRACE, U.S. corporate bond prices are reported and publicly disseminated every 15 minutes. Unfortunately, neither the OSC Fixed Income Paper nor subsequent CSA publications address the very important question of why that same standard cannot be adopted in Canada.

The OSC Fixed Income Paper also refers to the E.U. which, at the time of publication, was considering the same or similar issues. Since then, with the enactment of MiFID II, the E.U. approach has come into alignment with that of the U.S., and non-equity trades must be published within 15 minutes of execution, a timeframe that will reduce to 5 minutes in 2020.[13] This information is then publicly disseminated within 15 minutes of publication.[14] In the E.U., trade information is published by an Approved Publication Arrangement ("APA"), of which there could be many. The E.U. had anticipated that a single technology provider might emerge to consolidate the data of all APA's into a single consolidated feed but no such provider has emerged and, as a result, investors must visit several websites to get this information. While this is not perfect, it is an adequate solution in that the information is readily available in a timely manner, and much preferable to a system where transmittal of trading information is further delayed.

The 2015 Proposal

In September 2015, the CSA published the 2015 Proposal. The CSA stated the following three purposes for the 2015 Proposal[15]:

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.

We agree that these three purposes should be priorities. These three purposes are consistent with a drive to full and fair transparency and are consistent with the stated purposes of the Act. Put differently, having identified these purposes, one would have expected a transparency proposal similar to that in place for

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[9] OSC Fixed Income Paper, *infra*, p.26
[10] National Instrument 21-101 *Marketplace Operations*, Part 8
[11] 2018 Proposal, *infra*, p.4137
[12] OSC Fixed Income Paper, *infra*, p.27
[13] Association of Financial Markets in Europe, *MiFID II/MiFIR Post Trade Reporting Requirements: Understanding Bank and Investor Obligations,* September 2014, p.14 (s.2.3) (the "AFME Publication")
[14] *Ibid.*, s.2.4
[15] (2015), 38 OSCB 8067

many years for equities and/or similar to that adopted by the U.S. and the E.U. However, the 2015 Proposal proposed that transparency be on a T+2 basis and the CSA acknowledged this is significantly longer than the one-hour dissemination delay for CanPX.[16] In our comments, we explained why T+2 dissemination would be ineffective. From a buy-side perspective, our primary concern is obtaining the market price for fixed income securities at the time of purchase and disposition. A T+2 dissemination policy does not address that issue at all.

In our 2015 Comment Letter, we provided the following example of how the lack of transparency, leads to excessive profits by sell-side participants in the Canadian fixed income market:

> Friday, October 30, 2015, we found the following situation:
>
> Canadian issued 5% 2020 Transalta bonds were marked at $88.425, for a spread of 690 basis points. U.S. issued 4.5% 2022 Transalta issued bonds traded at $95.806, a spread of 304 basis points. Same issuer, similar duration, yet the spread was almost 400 basis points wider in Canada.
>
> This suggests that the "market makers" for Transalta in Canada are not looking to offer liquidity; they are looking to make excess profits and have no regard for liquidity. Even with the transparency of the biggest liquid market for these bonds in the world dealers do not provide liquidity.

This example is important because it is a direct application of the view that the market makers need not only make profits to participate in this market, but extraordinary profits at that. It is hard to understand how Canadian securities regulators can condone a practice where spreads are routinely higher in Canada not just by a small amount but significant amounts of money as represented by the 400 bps in the example above. This is unconscionable. We ask the CSA and other regulators whether they truly believe that if spreads were lowered from 700 bps to 300 bps all these dealers would exit the market? If this is a firmly held belief, we ask for evidence thereof. Anecdotal evidence is irrelevant in this instance because anyone who is faced with losing 4/7 of their compensation will react negatively. But that does not mean they will exit the market. We would further submit that, if dealers exited the market as a result, regulations can be quickly enacted to ensure the dealers participate actively in the market. Some examples of such regulations could include: (a) make engaging in market-making activity for fixed income issues a condition of registration; or (b) enact a requirement for the broker that acts as an underwriter or agent for a fixed income offering also act as a market maker for the issue.

The reason provided for adopting a T+2 timeframe was the use of the Market Trade Reporting System ("MTRS 2.0"). The CSA noted that the benefits of using MTRS 2.0 outweigh the potential impact of a longer delay in reporting. Given the historic lack of transparency, we were surprised with this position because it sacrifices meeting the three purposes in favour of expediency. There have been many CSA rule proposals over the years that have required technology investments and these proposals, once adopted, typically have a two- or three-year transition period the purpose of which is to provide sufficient time to design and implement a system that meets regulatory requirements. It is not clear why this approach was not suggested for fixed income trade transparency. The CSA position stands in contrast to that of the E.U., which has set a 15 minutes dissemination delay to start, with a set date to reduce that to 5 minutes, despite the technology not being in existence at the time the relevant MiFID II requirements were passed.

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[16] *Ibid.*, p.8071.

The 2018 Proposal

With the foregoing history, we turn now to the 2018 Proposal[17]. The key change from the 2015 Proposal to the 2018 Proposal is to disseminate fixed income trade information on a T+1 basis (5 p.m.). The CSA defends this approach due to concerns that "have been historically raised about the potential impact of transparency on liquidity and the willingness of dealers to provide liquidity if information about their transactions become immediately available."[18] This is a rather bold assertion yet in none of the publications cited herein does the CSA explain how disseminating this information after completion of the trade would have the effect of reducing liquidity nor is it apparent why this would be the case. It is worth noting that even if one could argue that a 15-minute delay would have the effect of reducing liquidity, it is not clear why a T+0 (5 p.m.) approach would not be appropriate. We are not endorsing this approach as a solution but as an interim measure to achieve compatibility with international standards.

Like its predecessor, the 2015 Proposal, we are concerned that the 2018 Proposal is not consistent with the stated purposes of the Act. Buy-side investors, including retail investors, will continue to be at an information disadvantage with respect to fixed income trades and this cannot be characterized as other than an unfair practice and certainly one inconsistent with the spirit of the Act. Whether a buy-side investor knows that they paid an unfair price at 5 p.m. on the day after the trade or two weeks later is of no consequence. In neither case is there anything they can do about it. With frequent, 15-minute dissemination, to the extent trades are done incrementally, the buy-side investor would be able to glean valuable information and pay a price for the security that is fair in all respects. Because of this deficiency, it is simply not possible to assert that the 2018 Proposal is consistent with fair and efficient capital markets. We have addressed fairness throughout this letter. We note that an efficient market relies on quick and comprehensive dissemination of information about issuers and data on trades. Nothing in the 2018 Proposal accomplishes that. The only purpose conceivably met relates to financial stability and reduction of systemic risk, although those arguments are dubious based on lack of any data or evidence in any of the OSC Fixed Income Paper, the 2015 Proposal or the 2018 Proposal that would support such claim. As such, the 2018 Proposal in present form is not consistent with the purposes of the Act. Moving to a 15 minutes dissemination delay would correct this deficiency and we urge the CSA to move forward on that basis.

Another reason to re-consider the 2018 Proposal relates to international experience. We are concerned that Canada is considering such a significant departure from the standards established by the two leading jurisdictions, the U.S. and the E.U. CSA members participate in many international fora through the International Organization of Securities Commissions and otherwise, and have increasingly over the years been part of broader efforts at global harmonization. It is interesting that as the U.S. and E.U. move to align the dissemination of fixed income trade information with the dissemination of equity trade information, the CSA chooses not to follow. We urge the CSA to consider global harmonization in this case.

The 2018 Proposal suggests other changes to fixed income transparency reporting in order to facilitate this effort, namely, for information processors to provide consolidated trade information rather than a real-time consolidated feed showing order and trade information. While we prefer full trade transparency, we acknowledge and agree that providing consolidated trade information is sufficient to meet the stated purposes of this exercise and suggest, further, that this militates toward more frequent dissemination than T+1. The 2018 Proposal also proposed that the IIROC be the information processor for both government fixed income securities and corporate fixed income securities, rather than just for corporate fixed income securities as is currently the case. We note that transparency in government issues has suffered for the lack of an information processor and, therefore, we support the proposal to assign this role to IIROC.

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[17] (2018), 41 OSCB 4134
[18] *Ibid.*

Annex A of the 2018 Proposal describes the framework for the transparency proposal. The CSA sets out the arguments on both sides of the debate, although it fails to explain why, considering the competing interests, the solution proposed is best. We respectfully request that the CSA issue a further notice explaining why it chose the option it did and rejected all other options.

In the 2018 Proposal, the CSA essentially asks the same question regarding its proposals on government fixed income and corporate fixed income reporting, namely whether these obligations should apply to banks, and in particular, Schedule III banks.[19] The CSA notes that if Schedule III banks are excluded, trades in government securities between such a bank and Schedule I or Schedule II banks, dealers, and interdealer bond brokers would still be caught. This would also apply to corporate securities. By phrasing the question in this manner, the CSA assumes that Schedule I and II banks will be included in these rules, once enacted, and we believe that is logical and appropriate. Schedule III banks should also be included as otherwise such banks may operate in a grey area as an agent for parties that seek to avoid trade reporting. One might even expect the Schedule III banks in this case to charge an additional fee to avoid reporting! This would not be at all consistent with the purposes of this endeavor as set out by the CSA; rather such would defeat the CSA's stated purposes. Therefore, Schedule III banks must be included.

Conclusion

Invesco is generally supportive of the 2018 Proposal, transparency in fixed income securities being an issue that affects us all, directly or indirectly. The CSA, at the instigation of the OSC with the publication of the OSC Fixed Income Paper, has engaged in a concerted effort to understand these issues and strike what it views as an appropriate balance between the omnipresent competing interests. Unfortunately, in our view, the CSA has erred too much on the side of the large financial institutions who make up the core of this market. Given the number of jurisdictions globally where same day trade information is made available, it is disappointing, at best, that Canada has opted for a less transparent approach. If the CSA proceeds on the basis of the 2018 Proposal, we urge the CSA to announce a set date to move to more frequent and earlier dissemination of trade data with a view to alignment with international standards.

Thank you for the opportunity to comment on this important matter.

Yours truly,

Yours truly,

Invesco Canada Ltd.

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cc. Peter Intraligi, President, Invesco Canada Ltd.
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[19] *Ibid.*, p.4139