NEW REGULATION

The Impact on Bond Markets – Buy Side Perspectives

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apg

tomorrow is today

UPCOMING REGULATION

- EMIR
    - Clearing requirements
- Mifid 2 and MIFIR
    - Market Structure (Exchange, MTF, OTF, SI)
    - Transparency requirements
- FTT
    - Financial Transaction Tax
- Capital Requirements Regulation
    - Regulatory capital

WHY DO INSTITIONS OWN BONDS ?

- Safe haven asset in the total portfolio (but a return requirement exists)
- Dutch pension funds still adhere on average to the 60-40 percent split in real assets vs. Bonds
- 40% allocation towards bonds, but large differences in allocation between sovereign risk and credit risk
- Low yields are (already) a challenge given a 6-7% return requirement

DEALER INVENTORIES AND LCS

- L(iquidity) C(ost) S(cores) is defined by Barclays as the cost of an institutional-size round-trip transaction, expressed as a percent of the bond's price

Liquidity Cost Score (LCS) =

OASD × (bid spread – ask spread)	if quoted on spread
(ask price – bid price) / bid price	if quoted on price

- Barclays concludes that dealer inventories have a significant (positive) impact on market liquidity

IMPLICATIONS OF (NEW) REGULATION

- Initial Margin – Cash & Bonds
  - Bonds used as initial margin - impact on liquidity ?
  - Pricing influenced by ‘eligibility’
- Market Structure
  - MTF, OTF, SI – only in an SI regime a dealer can trade vs. own capital. Currently low liquidity in MTF and OTF.
- Transparency
  - Pre- and Post trade transparency, Liquidity threshold, Large-in-scale and Price-reference-waivers, reporting on asset encumbrance

IMPLICATIONS OF (NEW) REGULATION

- FTT
    - Higher impact on instruments with short maturity, negative impact on liquidity
- Capital Requirements
    - Higher cost for inventory of bonds – lower liquidity
    - Sovereign risk keeps it’s low required regulatory capital

CONCLUSION & ISSUES TO DISCUSS

- Liquidity in Bond markets will be impacted negatively by new regulation
- Will we see a move from voice to electronic trading to mitigate the reduction in liquidity/volumes?
- What can we learn form the equities market ? What to prevent ?