SWEDISH
SECURITIES DEALERS
ASSOCIATION

2016-09-29

*Response to IOSCOs Consultation Report "Examination of Liquidity of the Secondary Corporate Bond Markets"*

The Swedish Securities Dealers Association (SSDA) welcomes the opportunity to comment on IOSCOs Consultation Report "Examination of Liquidity of the Secondary Corporate Bond Markets". The SSDA represents the common interest of 29 banks and investment firms active on the Swedish securities market. The mission of the SSDA is to promote a sound, strong and efficient securities market.

The evolution of market liquidity on secondary corporate bond markets has been of increasing concern among market participants in the past years. Efforts to investigate the issue of market liquidity and its recent development are therefore welcome.

It is not an easy task to measure market liquidity. It is not possible to measure all dimensions of market liquidity nor are there time series available for all markets. It is therefore difficult to draw any far reaching conclusions about the evolution of market liquidity. Although IOSCO recognizes these problems, it is unfortunate that it concludes that market liquidity for corporate bonds has not deteriorated markedly. The divergence between the conclusions drawn by IOSCO and the perception by market participants can probably be explained by difficulties to measure all dimensions of market liquidity as well as the predominance of US data in IOSCO's analysis.

Also, as there is much more data available for the largest markets such as the US market while there is hardly any available data for smaller currency areas, the conclusions drawn could not be applicable to smaller markets.

Additionally, some of the metrics used in the IOSCO analysis probably overestimate the level of market liquidity as a result of the very loose monetary policy conducted by several central banks in recent years. Price impact measures are, for example, likely overestimating the current state of liquidity. Price changes are not only due to changes in a corporate bond's market liquidity but also to other factors such as changes in its credit risk. Abundant funding liquidity as well as investors' search for yield have certainly contributed to compress credit spreads and thereby to limit the price impact in recent years.

Blasieholmsgatan 4B, 5tr, Box 1426, 111 84 Stockholm, Sweden
Tel +46 8 56 26 07 08, mail jenny@fondhandlarna.se
http://www.fondhandlarna.se

Moreover, just as IOSCO recognizes in the report, the current state of market liquidity does not say much about the future evolution. There is large concern that the positive impact on market liquidity from the abundance of funding liquidity will turn into a negative impact as funding conditions become tighter. The impact on the price impact measure could be brisk and instead indicate a severe deterioration in market liquidity. The pro-cyclical nature of market liquidity can lead to large effects on companies funding conditions as monetary policy is tightened. Traditional funding becomes more expensive at the same time as market based funding costs increase even more due to the likely increase in liquidity premia.

The impact of a severe decline in market liquidity can be very high for smaller currency areas, especially if the shock-absorbing capacity of the traditional market makers has been reduced. On smaller markets it is challenging (if at all possible) to change the market structure from a principal model to an agency model due to the reduced number of participants. The likelihood to find an investor with an opposite interest is smaller when they are fewer. Hence, the risk that is transferred to investors under the agency model is larger in small currency areas with few investors than on larger markets. The end result is that companies in small markets will have to pay considerably higher liquidity premia than those in larger markets when issuing new bonds.

Your Sincerely

Jenny Mannent