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IOSCO examines liquidity in corporate bond markets under stressed conditions

The Board of the International Organization of Securities Commissions today published a report that examines the factors affecting liquidity in secondary corporate bond markets under stressed conditions.

The report, prepared by IOSCO’s Committee on Emerging Risks, examines how liquidity in secondary corporate bond markets tends to evolve when those markets experience stress. The report seeks to increase understanding of how stressed conditions may affect both bond and other financial markets and the financial system more broadly.

The findings are drawn from a review of the literature on liquidity in corporate bond markets under normal and stressed conditions, an examination of past episodes of stress in corporate bond markets and discussions with a broad range of industry stakeholders.

The report notes that changes in the structure of secondary corporate bond markets have altered the way that liquidity is provided in these markets. These changes result from such things as post crisis regulations that have reduced the capacity of intermediaries to provide liquidity in secondary corporate bond markets; greater risk aversion on the part of intermediaries; the gradual introduction of electronic trading; and significant growth in the size of these markets resulting from central banks’ quantitative easing policies and low rates of return on other financial assets.

The report’s main findings include:
The structure of corporate bond markets has evolved since the financial crisis, driven primarily by changes in the behavior of market intermediaries and in the supply of and demand for corporate bonds.

A reduction in the capacity and desire of dealers to participate in corporate bond markets as principals could mean that future movements in bond prices in times of stress will be more acute than before.

Several characteristics of corporate bond markets should reduce the risk that strong price movements in bond markets will generate broader economic stress. These include effective liquidity management by issuers of corporate debt, reduced leverage and fewer leveraged players in the market than before the financial crisis, and the low frequency with which many corporations enter primary bond markets for financing.

The willingness, resources and ability of market participants to provide sufficient demand-side liquidity to help stabilize markets will be critical factors in determining how corporate bond markets operate under stress.

Mutual funds are unlikely to be a source of either considerable selling or price volatility under stress, particularly those funds with managers who have instituted strong liquidity management processes, including plans for operating under stressed conditions.

NOTES TO THE EDITORS

About IOSCO

1. IOSCO is the leading international policy forum for securities regulators and is recognized as the global standard setter for securities regulation. The organization's membership regulates more than 95% of the world's securities markets in more than 115 jurisdictions and it continues to expand.

2. The IOSCO Board is the governing and standard-setting body of the International Organization of Securities Commissions (IOSCO), and is made up of 34 securities regulators. Mr. Ashley Alder, the Chief Executive Officer of the Securities and
Futures Commission (SFC) of Hong Kong, is the Chair of the IOSCO Board. The members of the IOSCO Board are the securities regulatory authorities of Argentina, Australia, Belgium, Brazil, China, Egypt, France, Germany, Hong Kong, India, Indonesia, Ireland, Italy, Japan, Kenya, Korea, Malaysia, Mexico, the Netherlands (observer), Ontario, Pakistan, Panama, Portugal, Quebec, Saudi Arabia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Arab Emirates, the United Kingdom, and the United States of America (both the U.S. Commodity Futures Trading Commission and U.S. Securities and Exchange Commission). The Chair of the European Securities and Markets Authority and the Chair of IOSCO’s Affiliate Members Consultative Committee are also observers.

3. The Growth and Emerging Markets (GEM) Committee is the largest committee within IOSCO, representing close to 80 per cent of the IOSCO membership, including 11 of the G20 members. Dr. Obaid Al Zaabi, Chief Executive Officer, Securities and Commodities Authority, United Arab Emirates, is the Chair of the GEM Committee. The committee brings members from growth and emerging markets together and communicates members’ views and facilitates their contribution across IOSCO and at other global regulatory discussions. The GEM Committee’s strategic priorities are focused, among others, on risks and vulnerabilities assessments, policy and development work affecting emerging markets, and regulatory capacity building.

4. IOSCO aims through its permanent structures:
   • to cooperate in developing, implementing and promoting adherence to internationally recognized and consistent standards of regulation, oversight and enforcement in order to protect investors, maintain fair, efficient and transparent markets, and seek to address systemic risks;
   • to enhance investor protection and promote investor confidence in the integrity of securities markets, through strengthened information exchange and cooperation in enforcement against misconduct and in supervision of markets and market intermediaries; and
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• to exchange information at both global and regional levels on their respective experiences in order to assist the development of markets, strengthen market infrastructure and implement appropriate regulation.

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