

Market Making Structure and Evolution: World Bank Insights on Sovereign Bond Markets

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The Fixed Income Market Colloquium

4 – 5 July 2017

Ministry of Economy and Finance

Rome - Italy

Agenda

1 - WB SURVEY OF TRENDS IN SECONDARY MARKET LIQUIDITY

2 – ISSUER DRIVEN ETF

2 – FINAL REMARKS

SURVEY OF TRENDS IN THE SECONDARY MARKET OF GOVERNMENT SECURITIES

OBJECTIVE OF THE SURVEY

To obtain insights from the countries primarily with respect to:

- **perception** of changes in the liquidity in the secondary market
- **policies** put in place by DMOs to enhance liquidity

The survey has focused mainly on four main topics:

- 1) Electronic Trading Platforms:** market share, trading volume by type of ETP and of debt instrument, number of ETPs, type of operators
- 2) Primary Dealer System:** size and composition of PD group, obligations, support, incentives, sanctions
- 3) Alternative methods to market making:** call market, fixing, reference prices
- 4) Market infrastructure:** Central Securities Depository (CSD) and Securities and Settlement System (SSS)

The survey has been completed by 26 countries.

GEOGRAPHICAL BREAK DOWN OF CONTRIBUTING COUNTRIES

- **EMEA (total : 22)**

Albania, Bulgaria, Cameroon, Hungary, Latvia, Poland, Romania, South Africa, Serbia, Slovenia, Tunisia, Turkey, Ukraine (13)

Europe West (9): Austria, Denmark, Germany, Finland, France, Italy, Portugal, Sweden, United Kingdom

- **LATAM (2):**

Brazil, Mexico

- **ASIA / PACIFIC (2)**

Fiji, Philippines

Out of the 26 contributing countries

- **21** have a **PD** system
- **18** use (or are in the process of putting in place) an **ETP** system

PRINCIPAL OBSERVATIONS DRAWN FROM THE SURVEY

1. Market Liquidity

Turnover in the secondary market has tended to decline in mature markets primarily as a result of:

- regulatory pressures on dealers' balance sheet that have constrained dealers warehousing and trading capacity (Basel III, Solvency II, Mifid II, etc)
=> increased capital requirements and liquidity ratios; negative impact on repo market
- lower market yields and drain of market liquidity (QE)

By contrast, liquidity continues to improve in most developing markets which have put in place the reforms required to that effect.

PRINCIPAL OBSERVATIONS DRAWN FROM THE SURVEY

2. Primary Dealer Systems

Some evidences of lower liquidity are apparent in PD systems in mature markets :

- (i) Decreased appetite of some **market players** (in particular global players) to become PDs in some markets
- (ii) Efforts made by several **DMOs**
 - (a) to diversify and /or increase the incentives provided to PDs to motivate them to perform
 - (b) to help PDs manage some of the **risks** to which they are exposed, in particular by offering them a securities lending to decrease the risk of delivery failures: 8 countries

In several markets, the appraisal of the quality of a PDs' performance tends to increase the relative weight of its activity in the secondary vs. primary market , same as the relative weight of its quantitative vs. qualitative contribution.

PRINCIPAL OBSERVATIONS DRAWN FROM THE SURVEY

3. Electronic Trading Platforms (ETPs)

- The significant number of countries which are putting ETPs in place evidences that e-trading continues to be a major factor supporting **market development**. This point was illustrated during the conference in particular by Romania, South Africa and WAEMU.
- The average market share of ETPs in **West European Countries** (Austria, Dk, Fi, Fr, Italy, Portugal & UK) has been growing moderately (**44%** in 2014 and **50%** in 2016). **In other parts of the world**, Turkey and Mexico have the largest ETP market shares (**56%** and **35%**, respectively). The market share of ETP is growing in **Brazil**. The Stock Exchange has a significant market share only in **Turkey**.
- Anecdotal evidence suggests that lower market liquidity is having a mixed impact on the **relative importance of the transactions traded electronically or OTC**: the size of e-tickets is lower but the number of trades is higher.
- Overall, B2B has a larger volume than B2C. T-bonds have a larger volume than T-bills in both B2B & B2C.

PRINCIPAL OBSERVATIONS DRAWN FROM THE SURVEY

Alternative methods to market making and price discovery

- Several countries, especially in developing markets, use fixings or collect reference prices
- Call markets have been particularly successful in Brazil
 - Performed by brokers, OTC bid and ask offers among clients, scheduled during the day.
 - Rules are registered at Anbima (the Association of Financial Market Institutions)
 - In general, orders are placed by phone or “chats”
 - Price quotes are firm and for standard amounts
 - Clients are mainly institutional investors (investment funds and pension funds), bank treasuries and non-residents
 - Some brokers are able to gather up to 250 clients in the call
 - The most liquid form of trading for off-the-run government bonds and corporate bonds.

Could that be more widely used to complement PD quoting obligations?

PRINCIPAL OBSERVATIONS DRAWN FROM THE SURVEY

5. Market Infrastructure: CSD & SSS

The survey provides evidence that market globalization increases the importance of putting in place an efficient market infrastructure - in particular **linking CSD to an ICSD** - in order to enhance market liquidity.

The survey shows a variety of possible arrangements with respect to links:
no link, direct link or indirect link through a global custodian or SSS,
each type of link having its specific advantages and limitations.

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ISSUER DRIVEN
EXCHANGE TRADED FUND
SUPPORTING LOCAL CURRENCY MARKETS

What is the Issuer – Driven ETF project?

A World Bank Group initiative to support the development of local currency bond markets via an innovative Government Bond ETF structure.

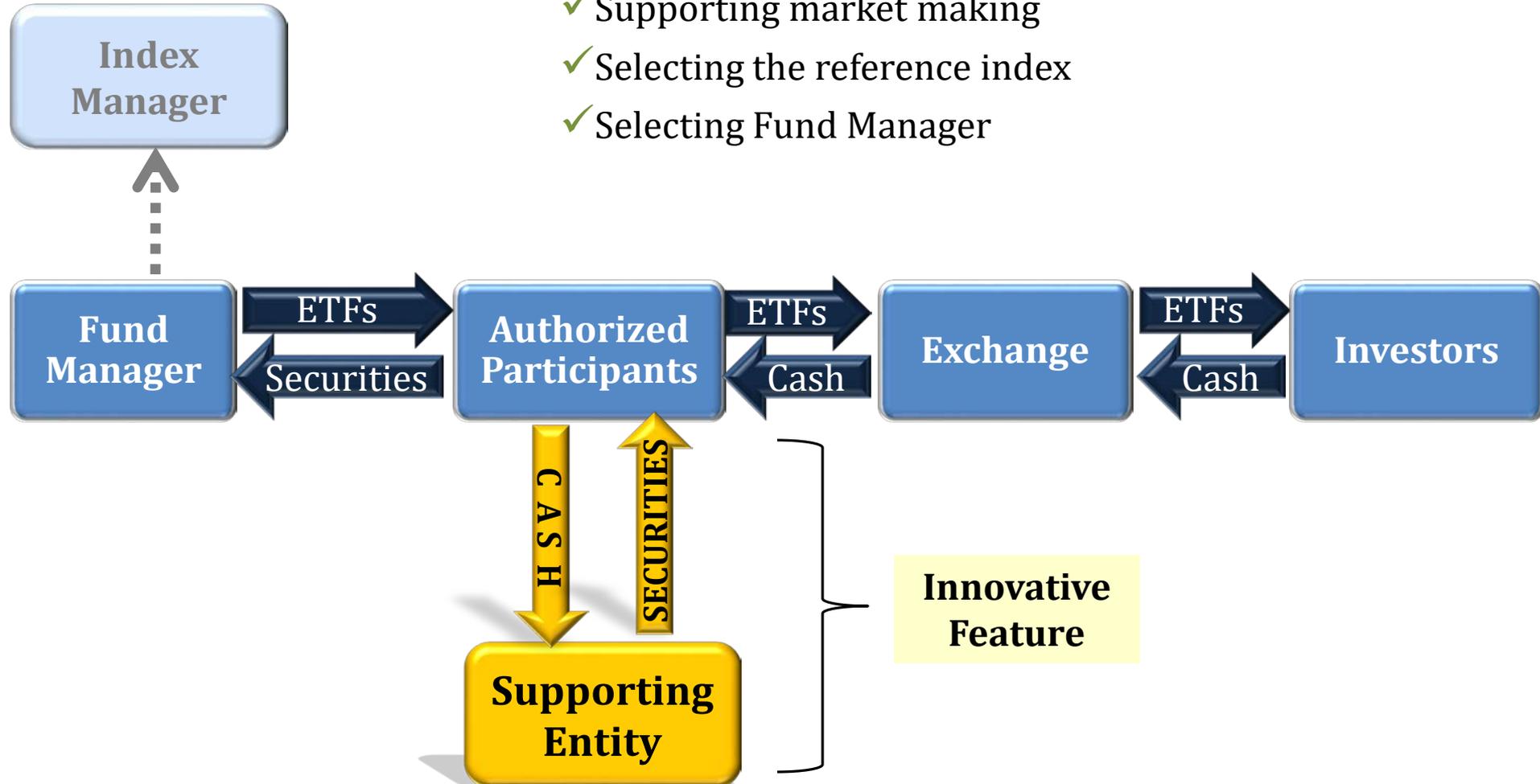
Key Innovation: Direct involvement of the issuer in the ETF structure which:

- facilitates efficient tracking and rebalancing,
- enhances business viability
- allows government to design ETFs that are aligned to development goals

Issuer – Driven Exchange Traded Fund Program

Four roles of the Supporting Entity

- ✓ Supporting the ETF launch
- ✓ Supporting market making
- ✓ Selecting the reference index
- ✓ Selecting Fund Manager



Key Pillars and Minimum Standards for I-D ETFs

Key Pillars of I-D ETF Concept	Minimum Standards	Objective
1. Primary Market Support	Guaranteed minimum volume of underlying securities	Enhanced economic viability and quality of the product.
2. Secondary Market Support	Incentives and measures to enhance liquidity	Higher liquidity, lower transaction costs and fees to investors
3. Adherence between Index and Development Objective	Proved link between ETF index and development objectives	Ensure focus on development impact
4. Transparent Selection of Qualified Fund Manager	Transparent, merit based selection process with robust criteria	Mitigate reputational risks Enhance credibility of product and likelihood of success

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Final Remarks

- Lessons learnt from the survey are directly reflected in the agenda of bond market reforms in several countries.
- Top topics of Technical Assistance in EMs include:
 - Primary Dealer Systems
 - Implementation of Trading Platforms
 - Implementation of Securities Lending Facilities
 - Design of benchmark building strategies (to enhance liquidity)
- Countries are also seeking alternative methods of trading. Would call markets be an option?