

THE NEXT STEPS

As corporate bond issuance in Australia appears – at long last – to be regaining its stride, market participants are turning their attention to developing the market further. With Australian corporate product traditionally among the least liquid asset classes in an already-illiquid market, methods for promoting secondary flow are under discussion.

BY KIMBERLEY GASKIN

It is a truism to say that the Australian domestic true corporate bond market is illiquid. Although 2010 was a watershed year for the asset class, with over A\$6 billion (US\$6 billion) of true corporate bonds pricing, the small size of the market profoundly inhibits two-way flow.

Investors continue to clamour for corporate assets, and the corporate paper that has been issued is tightly held at this still-early stage of the market's development. The status quo was amply demonstrated by the most recent corporate issue – Woolworths' A\$500 million five-year transaction, which priced within 24 hours at 105 basis points over swap or 5 basis points inside both its launch margin and the most recent comparable five-year big four bank issue. The book was four times oversubscribed and left many buyers wanting more, even without being offered into a wider Asian region which is itself keen to get its hands on more Australian credit (see box on p31).

"I've never experienced such brutal scaling as recently," reveals John Sorrell, head of credit at Tyndall Investments

(Tyndall) in Sydney. "The scaling is becoming somewhat absurd – but that's what happens in an undersupplied market." Sorrell adds that Tyndall received only one twentieth of its bid on one recent corporate deal.

Demand for corporate paper in the Australian market is now so strong that it actually reverses the very concept of illiquidity as it is currently being discussed in rates markets. While liquidity is often considered in the context of the likely availability of bids when investors want or need to sell, any corporate stock that is relinquished by Australia's grasping investors is snapped up at lightning speed by equally-hungry buyers. Comments Luke Fay, Sydney-based head of credit trading, Australia at UBS Investment Bank (UBS): "In the current market, buyers are holding paper tightly and there's really no fast money element in the market to dislodge it. But the market is extremely well bid – the ability to sell down corporate stock is phenomenal."

While Woolworths' spectacular result was a clear victory for the domestic market, originators still refuse to predict a sufficient increase in primary flow to unlock liquidity until domestic capital markets pricing becomes even more competitive.

There has been some convergence between alternative markets and domestic corporate bonds – for example, originators indicate the onshore-offshore bond market arbitrage has all but vanished. But it will take time, under any circumstances, to build up domestic bond outstandings and while

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JOHN SORRELL TYNDALL INVESTMENTS



that process is ongoing market participants are focused on how a range of new products and initiatives may assist current secondary activity and underpin the liquidity of the expected increase in supply.

CDS: VILLAIN OR HERO?

Outside increasing supply, a key area of interest has been the extent to which a more robust credit default swap (CDS) market may be able to contribute to liquidity by stimulating overall bond market development.

In November 2010 the Bank for International Settlements (BIS) reignited debate about the best way to enhance corporate bond market liquidity with a provocative paper on the link between CDS trading and the development of corporate bond markets throughout Asia.

Based on data derived from China, Hong Kong, India, Indonesia, Japan, Korea, Malaysia, the Philippines, Singapore and Thailand, the paper found that firms with CDS traded benefited through reduced issuance costs, of 18 basis points set against an average issuance spread of 115 basis points, with the bid-offer spread also narrowing by 2.1 basis points relative to an average bid-offer of 14.5 basis points.

Price makers and investors remain somewhat divided on the putative positive impact of CDS trading on the physical corporate bond market – in spite of the BIS’s findings in the wider Asia Pacific region.

UBS’s Fay believes that a well-functioning debt capital market requires an active, liquid CDS market. He argues that having a functioning market in the derivative product supports overall dynamics, thus promoting primary issuance.

But at this stage originators do not appear to be using CDS trading to inform their strategy, given the key hurdles to corporate bond issuance already noted – competing price and tenor from the loan and offshore bond markets. Comments Simon Ling, Sydney-based head of retail and wholesale fixed income origination at Commonwealth Bank of Australia (CBA): “It’s certainly not top of mind. Although a robust CDS market would be supportive it is not fundamental to driving issuance.”

Edwin Waters, director, debt capital markets at ANZ in Sydney, believes there may be a link between CDS and certain investment mandates – particularly when it comes to lower-rated credits. “Some investors may be unable to buy triple-B credits because there is no CDS on those names and therefore nowhere to hedge their exposure. Other investors may be more active in secondary markets if more CDS were traded. Consequently a CDS market for a broader range of names could help Australia develop a market further down the credit spectrum,” he comments.

But overall Waters does not consider CDS activity as a key driver of origination strategy at this stage. “It all starts with more supply – CDS needs public issuance, so the development of the CDS market is reliant on further development of the primary market.”

OFFSHORE INVESTORS HUNGRY BUT UNSATISFIED

THERE IS CERTAINLY A GROWING BID FOR AUSSIE CORPORATE PAPER OFFSHORE. BUT WITH SUPPLY SO LIMITED ADDING INTERNATIONAL INVESTORS IS PART OF THE LIQUIDITY PROBLEM, NOT ITS SOLUTION.

The best way to stimulate two-way flow is generally held to be the building of investor bases with different investment drivers – that way there is more likely to be a bid regardless of market sentiment. “The corporate market is strongly domestic institutional at this stage, so it is constantly moving in one direction,” confirms Rob Kenna, manager, securities origination at Commonwealth Bank of Australia (CBA).

The Kangaroo market is an excellent case of a market that has successfully developed buy-side plurality: its increasingly diversified mix of domestic and offshore fund managers, bank investors and central banks ensured the market was reasonably liquid following the knee-jerk freeze in 2008.

While offshore – and particularly Asian – credit buyers continue to favour US dollar-denominated securities global fund managers are taking more notice of all things Australian thanks to the country’s robust macro-economic outlook, high interest rates and high currency level.

Edwin Waters, director, debt capital markets at ANZ, reports that on most Australian dollar corporate deals 10-15 per cent of bids now come from Asia, regardless of volume – although allocation is scaled significantly below that level. “What’s particularly

significant is that the investors are different – a large range of buyers are buying more over time and buying different types of credits,” he comments.

A major benefit is the price tension Asian and other offshore buyers are expected to bring. “They will increasingly compete with domestic fund managers for supply, which will continue to add to price tension,” notes Waters.

However, it remains hard to claim that Asian investors are adding liquidity to the Australian dollar corporate market. With domestic dynamics featuring such a strong bid – and no outstanding inventory held in Asia to sell back – offshore demand is currently little more than another mouth to feed out of the slim pickings in primary supply.

It may be hard to place enough paper offshore to stimulate a diverse market. In spite of high level of interest, intermediaries note that international participation in domestic corporate bond deals is still small because there is no need for issuers to include them given the size of appetite from the domestic buying constituency. “The problem isn’t one of quantum of demand,” says CBA’s head of retail and wholesale fixed income origination, Simon Ling. “So it’s hard to argue that more Asian participation would improve liquidity at this stage.”

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LUKE FAY UBS INVESTMENT BANK

There is also some tension between domestic and offshore banks with regard to CDS trading versus primary origination. Many price makers in the CDS market sit offshore and do not extend balance sheet to Australian corporates looking for funds, or any secondary cash support to the market. “Merely trading CDS doesn’t build anything,” explains Glenn Hodgeman, global head of credit trading at Westpac Institutional Bank (Westpac) in Sydney. “We need to balance bond origination and secondary support with CDS trading to get a well-developed corporate bond market working.”

There is also a live debate about whether the Australian CDS market is itself developed or representative enough to provide the supposed beneficial effect on physical, domestic currency issuance. The Aussie iTraxx, which is based on US dollar underlyings, currently has 25 constituents (see table below) based on liquidity, which are rolled every six months. In the week ending February 11, 15 price makers met to vote on broadening the index by five names, but the measure failed to pass.

UBS’s Fay anticipates that the proposal will eventually be adopted and that the vote has been overshadowed by another material change in the iTraxx – the replacement of bank subordinated with senior debt. “Many investors and corporates have expressed their desire for an increase in the number of constituents so we can develop a more liquid CDS market and

they can gain more flexibility with their banks. Hopefully next time around price makers will agree,” he says.

Other intermediaries accept that timing may have been an issue. “We were very keen, as some names that currently don’t trade that often would have had an opportunity for increased liquidity by inclusion in the index,” comments Hodgeman. “But there were concerns over timing and over the nature of the liquidity poll.”

Currently index constituents are decided on the basis of a liquidity poll: price makers submit a list of their most liquid traded entities which are then aggregated and the 25 most liquid are included in the index. But not everyone is convinced the current constituents are the right ones.

“A number of price makers believe the constituents may need to be reassessed to determine that they really are the most liquid,” reveals Damian Wales, head of credit trading, Australia at Nomura in Sydney. “Using the poll approach is not always accurate. We need to ensure that the current index has the 25 most liquid names in the market before we move to 30 names.”

There are moves afoot to change the method of determining the iTraxx constituents to a more independent method – using trading volumes transacted through the Depository Trust and Clearing Corporation (DTCC). Westpac’s Hodgeman expresses a price-maker consensus with his belief that this would be effective in ensuring the liquidity of the index – over time. “When the European iTraxx crossover index migrated away from the dealer poll to using DTCC data to determine index constituents it was found that only 35 of the 50 names in the index were liquid – many names were not nearly as active as they thought.”

Some believe transparency in the CDS market – and potentially, as a result, the appropriateness of the Australian CDS index to the real state of play in underlying physical bonds – could be aided by advances in central counterparty clearing of credit derivatives. There are regulatory moves afoot in this market, too (see box on facing page).

AUSSIE ITRAXX CURRENT CONSTITUENTS

AMCOR
AMP
ANZ BANKING GROUP
BHP BILLITON
COMMONWEALTH BANK OF AUSTRALIA
CROWN
CSR
FOSTERS GROUP
GPT RE
JEMENA
LEND LEASE CORP
MACQUARIE BANK
NATIONAL AUSTRALIA BANK
WESTFIELD MANAGEMENT
QANTAS AIRWAYS
QBE INSURANCE GROUP
RIO TINTO
SINGTEL OPTUS
TABCORP
TELSTRA
TELECOM NEW ZEALAND
WESFARMERS
WOOLWORTHS
WOODSIDE
WESTPAC BANKING CORPORATION

SOURCE: MARKIT MARCH 21 2011

FIXED INCOME ETFS ON THE WAY

The retail market as a source of liquidity has also been a topic of considerable debate, particularly since the simplification of documentation by the Australian Securities and Investments Commission (ASIC) in 2010. In New Zealand, the relatively vibrant retail market has been used by wholesale investors as a place to sell down bonds for some years, with some fund managers saying they benefited significantly during the credit crunch by being able to raise cash from retail buyers.

CLEARINGHOUSE DEVELOPMENTS

THE DAMAGE INFLICTED BY NEGATIVE BASIS TRADES HAS PROMPTED A WAVE OF GLOBAL REGULATION OF OTC DERIVATIVES. WHILE OTC CLEARING IS COMING TO AUSTRALIA, IT MAY BE SOME TIME BEFORE THE COUNTRY DEVELOPS A CLEARED CREDIT DEFAULT SWAPS (CDS) MARKET.

The sheer scale of woe created by negative basis trades gone wrong in the US and Europe has sired a large population of new rules regarding the execution and reporting of over the counter (OTC) derivatives, most particularly CDS. The most notable of these is the US's widely-mimicked Dodd-Frank bill.

Australian traders indicate that over the last 12 months negative basis trades – where the CDS spread is less than the bond spread – have been occurring on some Australian names. "Levels between the two have largely ripped in now," says Damian Wales, head of credit trading at Nomura. "But that was a definite trend in 2010, in spite of the enormous losses incurred through negative basis trading throughout the financial crisis."

Originators continue to display concern over the relationship between CDS and primary issues when expressed through these trades. Simon Ling, head of retail and wholesale fixed income origination at Commonwealth Bank of Australia, does not like them. "We don't want to see negative basis trades locked in; it complicates the market considerably. Market participants are far more aware of it now and are looking to control CDS to a certain extent so the levels do not go out of kilter." Key regulatory developments include

increasing the standardisation of OTC derivatives, increasing the use of central counterparties (CCPs) to clear standardised OTC derivatives, improving transparency in the OTC derivatives market, increasing the use of collateral, and moving to daily exposure valuations and portfolio reconciliation for OTC derivatives that are entered into on a bilateral basis.

Central clearinghouses have already emerged in the US, while in November 2010 the Singapore Exchange (SGX) began centrally clearing financial derivatives – the first central platform to do so in Asia. SGX is also currently in negotiations to merge with the Australian Securities Exchange (ASX).

OTC clearing is coming to Australia, too. Comments Rohan Delilkhan, Sydney-based general manager, clearing and settlement services at ASX clearinghouse, Austraclear: "The Australian regulator has not mandated clearing of OTC derivatives in Australia, probably due to a desire to have better visibility of the

regulatory direction offshore and the relatively small scale of the domestic market, but more domestic regulatory guidance of Australian OTC clearing requirements is likely to eventuate. The Australian government joined in the G20 commitment to have OTC transactions centrally cleared by the end of 2012 so the market will need to get the structures in place to do so."

Regulators are pondering the best approach to this market. In May 2009 the Australian Securities and Investments Commission, the Australian Prudential Regulation Authority and the Reserve Bank of Australia published a survey of the OTC derivatives markets in Australia. Its recommendations are broadly in line with regulatory initiatives offshore, with a focus on standardising OTC derivatives, using electronic trading platforms and CCPs, and the greater use of collateral to mitigate counterparty credit risk.

"Australian regulatory authorities have yet to promulgate detailed proposals for the regulation of OTC

derivatives in Australia. It seems likely, however, that proposals in Australia will closely follow other jurisdictions, given the cost of developing an independent regulatory regime relative to the size of the Australian OTC derivatives market," comments Vittorio Casamento, senior associate banking and finance group at Freehills.

Traders are keen for an outcome – particularly with regard to central clearing of CDS. "It would be a very good development for the market," comments Nomura's Wales. "We may see more participation if market participants feel significant counterparty risk has been neutralised."

But it will take time for CDS to be included in any such clearinghouse or depository service. Says Austraclear's Delilkhan: "Interest rate and cross currency swaps are the clear focus at this stage for the Australian market due to the small size of its CDS market, but over time CDS could be included subject to stakeholder demand."

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ROHAN DELILKHAN AUSTRACLEAR



But a significant flow of retail bonds in Australia has yet to materialise. The most recent attempt, by Bendigo-Adelaide Bank, raised A\$90.5 million by the closing date of March 15. According to offer documentation up to A\$250 million was available in the deal, although market sources had commented on the skinny margin offered to retail investors by the bank.

Some believe that Australia needs a listed retail Commonwealth government securities market before a listed retail bond market can work. Such a market was a significant plank of federal treasurer, Wayne Swan's, December 2010 banking system reforms. But others believe the availability of a basket product – via fixed income exchange-traded funds



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EDWIN WATERS ANZ

(ETFs) – could entice the retail buying base into fixed income.

Comments Ray Anderson, fixed income manager, Asia Pacific at Interactive Data in Melbourne: “With the ever-growing pool of superannuation funds, the potential growth of fixed income ETFs could be the spark that the local corporate bond market needs. Retail investors, and particularly self-managed super funds, would be able to gain access to fixed income via an ETF – for instance, based on the UBS Composite Index.”

A key issue is the requirement for assets underlying ETFs to be listed on a World Federation of Exchanges market or to be a currency or commodity the pricing of which is set by a “robust and transparent” pricing mechanism. This standard is outlined by the Australian Securities Exchange (ASX) under AQUA rules. The initial drafting of these rules did not contemplate fixed income as an underlying asset for an ETF, but according to Matthew Gibbs, manager, corporate relations at ASX Group in Sydney, ASX has redrafted the rules for the specific inclusion of fixed income or debt as an underlying asset.

A key benefit could be on the cost side. Retail trades remain problematic given high distribution fees. But the basket approach could help neutralise the cost by adding a proxy wholesale investment vehicle – allowing the distribution process to be rationalised between the wholesale originator and the end retail investor and therefore making retail deals much more cost effective. On a single name basis this is less likely, but a fixed income ETF could use this approach.

The product is already in use around the Asian region. “Fixed income ETFs are a natural iteration of the existing equities ETF market and a key development in migrating retail investors towards fixed income product,” comments Zac Wallis, ETF strategist at Morningstar in Sydney. “We do believe the product is coming soon.”

Frank Henze, Singapore-based head of ETFs Asia Pacific at State Street Global Advisors (State Street) reveals his firm is actively pursuing the opportunity to launch a fixed income

ETF in Australia and is currently involved in the dialogue between the regulator and the ASX. State Street currently runs an Asian fixed income ETF – the ABF Pan Asia Bond Index ETF – the constituents of which are government bonds issued in the local currencies of eight countries in Asia.

“We’ve seen good success with that product and think there is an opportunity to help Australian retail investors access an investment that provides current income for their financial planning needs.” Henze says.

Likewise Vanguard Investments (Vanguard) is considering opportunities to launch fixed income ETF product into the Australian marketplace. The company has a significant product range in the established US market – where 15 per cent of the US\$1 trillion in ETFs are fixed income related. Underlying assets include both US Treasuries and investment-grade corporate bonds. “Once the listing rules change there is real scope for this product to work in Australia – we see clear demand for it,” comments Robyn Laidlaw, Melbourne-based head of product management and development at Vanguard.

The company has launched ETFs off existing index funds – most recently off Australian shares and property funds. “Vanguard in Australia manages over A\$19 billion in fixed interest so we see real opportunities for fixed income ETFs, but will have to wait for the detail of the regulatory changes before finalising a product offer,” Laidlaw explains.

Most market participants are intrigued and believe a fixed income ETF could represent a real breakthrough. “Investors certainly want a portfolio approach,” Rob Kenna, manager, securities origination at CBA in Sydney, tells *KangaNews*. “There are ETF-type products being put together for middle market and sophisticated investors, but a retail product is the next logical iteration.”

There are some questions as to whether the yield equation will work in an ETF-type structure, given the return hurdle on any fixed income investment is assumed to be offering a yield more attractive than what retail investors can currently achieve in term deposits.

State Street’s Henze points out that return is never guaranteed on any product, particularly on a market risk-based product like an ETF, but giving investors a diversified range of investment tools is still important. The liquidity that should be available in ETFs could also give them an edge over the longest tenor – and therefore highest yielding – term deposits.

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ROBYN LAIDLAW VANGUARD INVESTMENTS



But Stephen Nash, Sydney-based head of strategy and market development at FIIG Securities, is sceptical that illiquid corporate bonds could ever create a liquid ETF, even with diversification benefits. “ETFs would only work with Commonwealth government, semi-government, supranationals and possibly covered bonds. You need underlying liquidity for the product to work,” he argues. “By excluding corporate bonds you also reduce the ETF yield, so I also wonder if the resultant lower yield will reduce demand for a fixed income ETF.”

Nash argues that if retail investors want exposure to equities then ETFs are a relatively attractive investment format, as the product provides full diversity with a low management fee. “But the more senior credit position, which is typically afforded in fixed income, makes direct holdings both more feasible and effective when compared to equities, if adequate credit work is provided by the provider of the bond,” he says.

Henze admits the liquidity of the underlying bonds is important to the success of an ETF product, but he believes a corporate bond ETF could still work. “Aggregate high yield products have been successfully developed – the ETF industry has moved into asset classes that have structural challenges and liquidity is one of those challenges. I can see this happening in Australia,” he explains. “Sometimes an ETF can trade more heavily than the underlying physical bonds. In this instance the ETF acts as a convenient wrapper on the underlying issues – this is part of the value an ETF brings to the table.”

TRACE-ING LIQUIDITY

Whether or not new product types would promote the domestic corporate market, for the Australian regulator – and retail and wholesale investors – transparency remains paramount to proper corporate bond development. But there are major issues regarding what level of transparency best promotes liquidity that are yet to be resolved.

One interesting precedent comes from the US. In 2002 the country’s Financial Industry Regulatory Authority (FINRA) implemented a mandatory electronic reporting system for corporate bond trading, called the Trade Reporting and Compliance Engine (TRACE). Under this system almost all investment grade and high-yield corporate bond trading in secondary markets must be reported to TRACE within 15 minutes of execution. Post-trade information is then made available to all market participants through FINRA’s website. On March 1 2010 the system was extended to include primary market transactions and agency and government-sponsored enterprise debt. On May 16 this year the system will be extended again to include asset-backed securities transactions.

Some believe the system is a perfect test case for the role of transparency in enhancing liquidity, particularly given

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ROB KENNA COMMONWEALTH BANK OF AUSTRALIA

the Australian regulator and exchange are currently reviewing transparency on OTC secondary market transactions. But observers are divided as to the overall impact of TRACE reporting on US bond market liquidity. In 2006 and 2007 three impact reports found that TRACE reduced bid-offer spreads by 5-8 basis points and 0-67 basis points respectively, with no impairment of liquidity.

Other market participants are not convinced that the reports’ approach was accurate. In a rebuttal paper, Jerry Templeman, formerly a high-yield bond trader at Putnam Investments, argued that the studies investigated dealer mark-ups – an implicit cost – but treated them as if they were explicitly-costed commissions, and referred to them as bid-ask spreads. “That the studies found dealer mark-ups have decreased following the introduction of TRACE is not unambiguously positive for investors. Instead, the situation could be that a reduction in mark-ups has occurred because fewer trades have been executed on a principal or capital risk basis and more on an agency or risk-free basis, or that relatively fewer and smaller trades have been completed following the introduction of TRACE,” he commented.

Templeman also argued that the studies neglect to look at other execution costs, such as price impact and opportunity cost, both of which have been influenced by TRACE

Australian market participants are equally divided as to the benefits of TRACE-style reporting. Views on transparency in the Australian wholesale market range from the very optimistic to the decidedly more realistic, with banks tending to fall on one side and investors the other. Comments Tyndall’s Sorrell: “The bid-offer is not at all transparent at the moment – it can’t be in a market where there is limited corporate bond paper being sold to a large group of investors. And I think you’d have an interesting time if you actually tried to test brokers’ quoted offers – you’d probably find prices move significantly away from where they are quoted because at this moment liquidity is so firmly on the sell side.”

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STEPHEN NASH FIIG SECURITIES



AUSTRACLEAR CONSIDERING REPORTING ENHANCEMENTS

WHILE AUSTRACLEAR SEEMS UNLIKELY TO IMPLEMENT A SYSTEM LIKE THE US TRADE REPORTING AND COMPLIANCE ENGINE (TRACE), THE EXCHANGE IS IN DISCUSSION WITH ITS REGULATOR AND OTHER STAKEHOLDERS ABOUT HOW A MORE GRANULAR REPORTING REGIME MAY AFFECT LIQUIDITY.

TRACE was implemented in the US under the aegis of the Federal Reserve and it is clear that Australian regulators would have to become involved for there to be any substantial change in the local corporate bond reporting regime. At this stage market participants say there is not believed to be any such regulatory impetus in Australia.

Australian regulatory authorities – such as the Australian Securities and Investments Commission – have not mandated bond market reporting requirements along

the lines of those required in the US. However, Austraclear representatives have had high level discussions with some regulators and market stakeholders about improving post-trade transparency through the use of Austraclear trade settlement information. Rohan Delilkhan, general manager, clearing and settlement services at Austraclear, understands the market view that greater transparency has to be managed carefully as it can be a double-edged sword.

He confirms that Austraclear is wary of inadvertently impeding liquidity in already illiquid securities in the cause of transparency. “Our discussions with stakeholders indicate that there are divergent views on how far transparency should go,” Delilkhan comments. “The buy side is generally indicating a desire for more and detailed information – such as line-by-line securities reporting. The sell side, however, is concerned about sustaining its ability to make markets across a wide range of securities.”

Delilkhan notes that the US experience had been mixed in this area with a compression in bid-offer spreads accompanied in some cases by a reduction in liquidity with fewer participants willing to quote. He has also received feedback that using information for particularly illiquid stocks with infrequent or very small transactions could distort market valuations of those securities, particularly in distressed market situations.

Austraclear will be continuing discussions with regulators and market stakeholders on what information is suitable to present to the Australian market, says Delilkhan. “I am optimistic that there will be an outcome that increases transparency but we are unlikely to implement a mechanism with the same degree of transparency as TRACE.”

Inevitably, lines are also drawn on either side of the enhanced transparency argument. Interactive Data’s Anderson believes a TRACE-style reporting mechanism would benefit the Australian market considerably by transferring power back to brokers. “In Australia, I believe that the most logical solution to help increase transparency in the fixed income markets would be for Austraclear to create a TRACE-style system. Austraclear is the dominant clearing house and a member of ANNA – the body that issues ISINs.”

For its own part, Austraclear says it is unlikely to introduce a system like TRACE – but it is open to promoting trading transparency in consultation with market users (see box on this page). Most investors like the idea of ramping up transparency in Australia, particularly as the country is already accepted to be somewhat behind the eight ball in the Asia Pacific region. ChinaBond, sponsored by the China Government Securities Depository Trust & Clearing Company, is providing enhanced transparency on the Chinese bond market while the Korea Securities Dealers Association and the Philippine Deal and Exchange Corporation have developed tools to assist with improving transparency with differing levels of trade reporting.

There is also an argument that better transparency in the OTC market could underpin the involvement of the retail buying base. “We would support any moves in that direction, particularly if it ends up encouraging retail investors to engage in the OTC bond market more significantly,” comments FIIG’s Nash. “Retail investors have been forced to go to an equity exchange in order to trade in bonds, when the majority of bond trading is, has been, and probably will always be on an OTC basis. In other words, it is apparent that we need to more adequately align the trading format of bond trading, the OTC market, to the needs of retail investors.”

But there may be a sting in the tail for larger investors. Price makers are reluctant to argue that more transparency would be bad for the Australian market, but several do express reservations. Westpac’s Hodgeman has observed the TRACE system at work in the US and believes it does impede liquidity. “It is useful for pricing, but it alerts everyone, including competition, to remark their books, which makes it very difficult to then get out of positions. Many market participants have stated that liquidity in the US corporate bond market has suffered.” •

“Merely trading CDS doesn’t build anything. We need to balance bond origination and secondary support with CDS trading to get a well-developed corporate bond market working.”

GLEN HODGEMAN WESTPAC INSTITUTIONAL BANK