Leveraged Finance News

leveragedfinancenews.com Vol. 4, No. 37 September 29, 2014

FINRA Pushes for More HY Trading Transparency

An increasing share of corporate bond trades are taking place on electronic venues, and the Financial Industry Regulatory Authority (Finra) wants them to start disclosing more information.

The corporate bond market is highly decentralized, and most transactions still take place over-the-counter, with dealers and brokers communicating on the phone or electronically. These trades are reported to Finra via its Trade Reporting and Compliance Engine (Trace).

Finra unveiled three proposals Sept. 19; the first would require member firms of electronic exchanges, also known as alternative trading systems (ATS), to provide information about the quotes that they display to subscribers. (This information would be used by Finra "for regulatory purposes," and not disseminated.)

The second proposal would require member firms to disclose prices of retail-sized (100 bonds or less) same-day principal transactions (sales of bonds purchased from clients the same day), effectively revealing their markups.

The third proposal would require member firms to identify, in daily reports to Finra's Trade Reporting and Compliance Engine, all transactions with non-member affiliates and to identify when these transactions occur intraday at the same price.

"Clearly there is an intense regulatory focus on transparency in the bond markets," said Reuben Daniels, co-founder, chief client officer and managing partner for investment firm EA Markets. "This is an extension of what has been going on for several years with Trace and its disclosure rules to increase transparency

(See **HY Trading** on page 4)

Inside This Issue

Data

Fitch Raves on Revolver Recoveries

With the exception of "highly cyclical" commodities businesses or an occasional instance of fraud, secured lenders of revolvers and asset-backed loans have largely experienced full recoveries in bankruptcy proceedings over the past nine years, as detailed in a new report by Fitch Ratings.

The list of full recoveries includes bankruptcies filed in the aftermath of the financial crisis, according to a Fitch analyst, and helps support the high recovery ratings that Fitch and other ratings agencies have traditionally placed on those credit facilities despite the fact they are usually heavily drawn at the time of a filing.

"We had never done a broader, cross-sector study making sure we were on point on the assumptions of revolver utilization as of a bankruptcy date," said Fitch managing director Sharon Boneli, who covers U.S. corporates.

Fitch found an average of 90% recoveries for 92 asset-backed or revolver loans of speculative-grade companies in its

(See **Revolvers** on page 5)

Investors Playing Nice with Toys 'R' Us

High yield investors and lenders who had been waiting for Toys "R" Us to step forward on its problematic debt situation took notice in August when the toy retailer hired a restructuring specialist to take charge of its corporate finances.

This week, they leaped to attention when Toys "R" Us finally made its move, in launching a $1.38 billion loan refinancing proposal through Goldman Sachs.

According to Markit, three existing loans and a notes issue that are being refinanced took a major pricing leap after the company outlined plans in a Sept. 23 registration filing to issue new term loans of up to $1.025 billion in addition to a new $350 million revolver tranche. The new debt is to refinance $1.23 billion in outstanding loans maturing be-

(See **Toys** on page 6)

HY Trading
continued from page 1

in the fixed income markets."

The fixed-income proposals were part of a broader package that includes proposals that would compel trading firms that develop computerized trading algorithms to register with Finra, among other things.

All of the proposals have been adopted by Finra's board of directors and will now be formally drafted and issued for public comment. The comment period typically lasts one or two months, after which Wall Street's self-regulator may choose to make changes before submitting them to the Securities and Exchanges Commission. The S.E.C. will also seek public comment that may result in changes.

The push for more disclosure comes as electronic trading platforms siphon off an increasing share of trading activity. MarketAxess, one of the more established venues, sees about 5% of junk bonds tracked by Trace. Its high yield bond trading volume for the year to date is up 80% over 2013, Sandy White, head of high yield products at the firm, told *Leveraged Finance News*. (MarketAxess has made even bigger inroads in the investment-grade bond market, where it accounts for about 15% of Trace volume.)

New players continue to enter the market. In early September, Investment Technology Group announced plans to launch a dark pool trading venue for corporate bonds, a sure sign that the space is heating up. ITG is better known for stock trading platforms used by leading securities traders.

Goldman Sachs and BlackRock also operate corporate bond trading platforms that compete with MarketAxess, Bonds.com and others.

There is even an electronic venue for trading bond ETFs. In May, MarketAxess and BlackRock launched a partnership to provide iShares Fixed income exchange-traded fund trading services.

The new rules are only the latest effort to increase transparency in the fixed-income markets. In June Finra begin sharing data on transactions in the private "Rule 144a" market for corporate debt. Transactions that rely on exception to securities laws to avoid registration with the S.E.C. now account for 30% of the average daily trading volume in high yield corporate bonds.

By comparison 144a transactions account for 13% of trading in investment grade corporate debt and about 20% of all corporate debt trading.

There has always been some resistance to disclosure in the bond market. Increased transparency tends to narrow the difference between bids and offers, which is a boon to investors. But it is less favored by sell-side brokers, who typically take a cut of that spread and might be inclined to keep less inventory if their profits are reduced.

"Even though we are beginning to see some acceptance of increased transparency, general resistance on the sell side remains extremely high," Daniels said. "As big an improvement in transparency that Trace has been, the fixed income markets are still not as transparent as one might find in the equity trading markets."

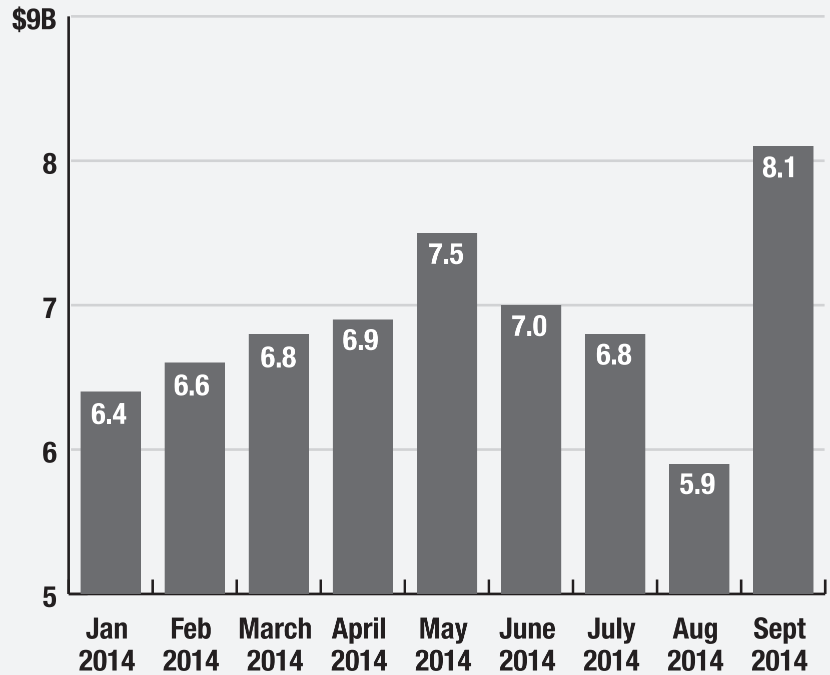
Transparency isn't the only reason that high yield bonds are generally less liquid that equities or even investment grade corporate bonds. There are multiple classes of junk bonds put out by a single issuer, many with different coupons and covenants. Equities usually consist of one or maybe two or three classes of securities in the cases of preferred shares.

But advocates for more transparency said that there is still much more room for improvement. "Although the fixed income markets may never achieve the transparency that exists in equity markets, it is reasonable to expect that innovation and advances in technology can begin to address the challenges," Daniels said.

While transparency presents challenges, liquidity is on the upswing by at least one measure: trading volume. The average daily high yield bond trading volumes for September is $8.1 billion, a significant increase from August's $5.9 billion daily trading average. Year-to-date, trading daily volumes average $6.9 billion, an increase from $5.6 billion in 2013. —*MS*

Trading Up the HY Volumes

Averagy High Yield Bond Daily Trading Volumes



Source: TRACE

