## FSB Report on the functioning and resilience of CP and CDs

The FSB recently released a Report on *Enhancing the Functioning and Resilience of Commercial Paper and Negotiable Certificates of Deposit Markets* (the FSB Report), which analyses the functioning and vulnerabilities of commercial paper (CP) and certificates of deposit (CD) markets and assesses the relative merits of potential market reforms to address them.

The Report forms part of the FSB's work programme on enhancing the resilience of non-bank financial intermediation (NBFI), and follows up on a 2021 FSB Report which identified some structural vulnerabilities in short-term funding markets, as well as a lack of granular data in parts of those markets.

The FSB Report states that, since the March 2020 COVID-induced market turmoil which required significant central bank intervention, much work has been carried out by authorities in several jurisdictions to improve the resilience in CP markets and the overall functioning and resilience of short-term funding markets. But it echoes the importance of effective measures to build liquidity resilience in non-banks (such as money market funds (MMFs)) being implemented across jurisdictions. While these measures may support the functioning and resilience of CP markets, the market's susceptibility to illiquidity in times of severe stress remains.

### *Main causes of vulnerability in CP market*

*Illiquidity:* Given its short-term nature, CP is generally considered to be a buy-to-hold instrument, often matching investors' short-term liquidity horizons. But this characteristic can also make it susceptible to illiquidity in times of stress because there is very little secondary market activity. Dealers can provide secondary market liquidity by bidding paper back from clients, but in times of stress, constrained risk and balance sheet capacity may lead to dealers being unwilling, or unable, to provide a price. The relatively small number of dealers and investors in this market may also result in limited liquidity.

*Transparency:* Transparency in the CP market is fragmented, with no single public or private holistic overview of the market. So dealers become an important source of information to issuers, providing information to market participants on price discovery, demand and supply. This could potentially result in over-reliance on dealers and may exacerbate illiquidity due to information asymmetry amongst market participants.

*Fragmentation:* Vulnerability also stems from the fact that CP markets can be highly fragmented, with sometimes little standardisation in terms of legal and regulatory frameworks, documentation, issuer eligibility, maturity and denomination profiles, and settlement cycles. Additionally, dealer workflow processes including ISIN creation can be inefficient.

### *Measures to enhance liquidity and resilience*

The FSB Report identifies certain measures which could potentially be considered to enhance the liquidity and resilience of CP markets. These involve:

- Enhancing regulatory reporting for completed transactions, potentially including secondary market transactions, which would enable national authorities to better monitor the size of CP markets, as well as any trends, such as issuance and investor concentration in particular sectors, ratings, issuers etc, which over time may help in the monitoring of vulnerabilities.
- Improving publicly available databases in certain jurisdictions by publishing outstanding amounts broken down by types of issuers and investors, yields, maturity distribution, and other characteristics on a frequent basis, which may reduce information asymmetry amongst market participants and may result in greater participation and increased dealer disintermediation.

  But while increased transparency might be helpful for market functioning in normal times, the FSB Report also says it is less clear that it could mitigate the vulnerabilities in these markets during periods of stress. It also sets out important considerations around increased public disclosure of investor profile and post-trade transparency, including pricing, such as that issuers fearing misinterpretation of their data may forgo using the CP markets in favour of private placements (as was the conclusion of an ICMA survey reported on in the Q2 2023 edition of this Quarterly Report).
- Encouraging market microstructure adjustments such as standardisation and digitisation of documentation and encouraging further development of platforms to facilitate more efficient primary and secondary market activity and shorter settlement conventions in certain jurisdictions (eg enabling T+0 settlement more widely), and operational processes, where significant impact would likely arise from increased automation of post-trade/downstream processes (eg obtaining an ISIN).

The FSB Report also explores ways to enhance liquidity through private repo markets, as to which it suggests that more efficient trade processing might improve transparency and support expansion of private repo markets. However, it also highlights that developing a private repo market for CP collateral should be carefully weighed against the existing limitations, potential risk management challenges, and feasibility considerations.

### *Conclusion*

The FSB Report concludes that these potential market reforms may have a positive impact on CP market functioning in normal times – particularly if used in combination and appropriately tailored to each jurisdiction – but they would likely not, on their own, significantly enhance the resilience of these markets. Accordingly, authorities are encouraged to explore the usefulness of these reforms for their own markets, as the relative merits and operational considerations will vary significantly across jurisdictions. The potential market reforms would also need time to be designed and implemented, which may require cooperation between public authorities and market participants.

For now, the ICMA Commercial Paper & Certificates of Deposit Committee (CPC) has noted the contents of the FSB Report. After having tracked relevant proposals from the FCA and other regulators, including how they intend to ensure consistency with each other, the CPC will convene to discuss any ensuing developments.

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