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# New York Federal Reserve Staff Report on Regulation and Bond Market Liquidity.

Recently, the New York Fed issued a staff report about the relationship between increased regulation and bond market liquidity entitled, *Dealer Balance Sheets and Bond Liquidity Provision*. The full report can be accessed <u>here</u>. The authors conclude that new bank regulatory constraints faced by the most active bond traders in the market have impacted bond market liquidity. This is a somewhat significant conclusion given that the NY Fed, and other regulators, have <u>argued</u> corporate bond market liquidity has not deteriorated.

BDA will be sure to discuss the report's conclusions during Capitol Hill meetings on the impact of regulations on the fixed-income market. Please contact the BDA if you'd like to discuss the report further. Thank you.

## **Focus of the Staff Report:**

- The authors study the links between dealer balance sheet capacity, bond market liquidity, and the role of increased capital and liquidity regulation (Basel III) and trading activity regulation (Volcker) on bank holding companies with broker-dealer affiliates.
- The banks analyzed are bank holding companies with broker-dealer affiliates and the trading data is based on the supervisory version of TRACE, which means the name of the FINRA member that reports a trade to TRACE is known.

### **Key Takeaways from the Staff Report:**

- The authors state that historically the bonds that are actively traded by banks with with greater leverage, higher trading revenue, higher liquidity mismatch, and higher vulnerability are more liquid.
- However, the authors conclude that since the beginning of the implementation stage of the new bank regulatory regime in 2014 a shift has taken place. And the bonds more actively traded by more leveraged institutions (as described above) have become less liquid than before the implementation of the new regulatory regime.

We hope this information is valuable. Please contact the BDA if you have any questions.

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#### **Bond Dealers of America**

January 11, 2017

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