



# Statement of Good Practice

## Grey Market Trading

# Introduction

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## Financial Markets Standards Board

Financial Markets Standards Board (“FMSB”) was established in 2015 in light of the recommendations of the Fair and Effective Markets Review in the UK with a mandate to issue Standards designed to improve conduct and raise standards in wholesale financial markets. FMSB has built up a body of Standards (“Standards”) and Statements of Good Practice (“SoGPs”) over time, prioritising those areas where FMSB member firms (“Member Firms”) consider there is a lack of clarity in the standards of behaviour expected of market participants, or a lack of understanding of the issues relevant to a product or transaction type, or evidence of poor conduct.

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## Applicability of FMSB Statements of Good Practice (SoGP)

SoGPs are issued by FMSB from time to time. SoGPs do not form part of FMSB Standards, and they are not subject to FMSB’s adherence framework. Rather, they reflect FMSB’s view of what constitutes good or best practice in the areas covered by the SoGPs in question. Member Firms are expected, and other firms are invited, to consider their own practices in light of the relevant SoGP and make any changes to such practices that they deem to be appropriate. Failing to do so will not, however, create any presumption or implication that a firm has failed to meet its regulatory or other obligations.

Full details of the Member Firms are available at <https://fmsb.com/>. SoGPs will be shared with non-member firms and their affiliates, who are encouraged to consider them. Information on SoGPs will be made available to users of the wholesale markets (e.g., corporates and end investors) so that they may be made aware of their existence and FMSB’s expectation of market conduct. FMSB will, as part of its normal course of business, periodically review the applicability of its published SoGPs to ensure they are relevant and up-to-date for market conditions.

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## Relationship with law and regulation

FMSB Standards and SoGPs do not impose legal or regulatory obligations on Member Firms, nor do they take the place of regulation. In the event of any inconsistency, applicable law, rules, and regulation will prevail. In developing Standards and SoGPs, certain regulators may have commented on their drafting, alongside Member Firms and other bodies, such that the Standards and SoGPs, once finalised and published, are intended to represent an authoritative statement of global good practices and processes. However, they are not normally endorsed by regulators. Where they are endorsed by a regulator, that will be made clear on the face of the Standard or SoGP in question.

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## Relationship with other codes

Other Codes already exist in relation to certain markets, such as the FX Global Code, while others are in the process of being produced. Some overlap exists between the work of FMSB and such other bodies and FMSB will seek to ensure it adopts a consistent approach in cases of overlap wherever possible and will seek to avoid issuing a Standard or SoGP where the subject matter is already covered adequately by existing regulation, or a Code issued by another body. It may draw attention to Member Firms of an existing code and request that Member Firms act in a manner consistent with it once appropriate steps have been taken to confirm its applicability.

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# I. Explanation

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## 1. Purpose

**1.1** This Statement of Good Practice is intended to:

- (i) Promote a common understanding of the role, benefits and risks of grey market trading (GMT) across issuers, investors and syndicate banks; and
- (ii) Identify key considerations for syndicate banks prior to deciding to conduct grey market trading in different contexts.

**1.2** Banks have historically adopted varying approaches to GMT where they are also involved in the syndication<sup>1</sup> (see Section II, para 2). This Statement of Good Practice sets out a common set of considerations for firms when determining their approach to GMT in different contexts. Whether, and in what circumstances, a bank elects to engage in GMT is a commercial decision to be made by such bank taking into account any relevant risks and its ability, through applicable control frameworks, to mitigate any such risks.

## 2. Scope and applicability

**2.1** This SoGP applies to firms engaging in GMT in relation to syndicated transactions in UK and other European markets. Due to the different market dynamics, bonds issued by way of publicly announced auctions are not in scope of this SoGP.

**2.2** The Good Practice Statements (GPS) are intended to apply to all market segments, including corporate and SSA primary market issuances.

**2.3** The GPS are not intended to apply to tap issues on the basis that a market already exists in the original securities which are fungible with the additional securities issued under the tap.

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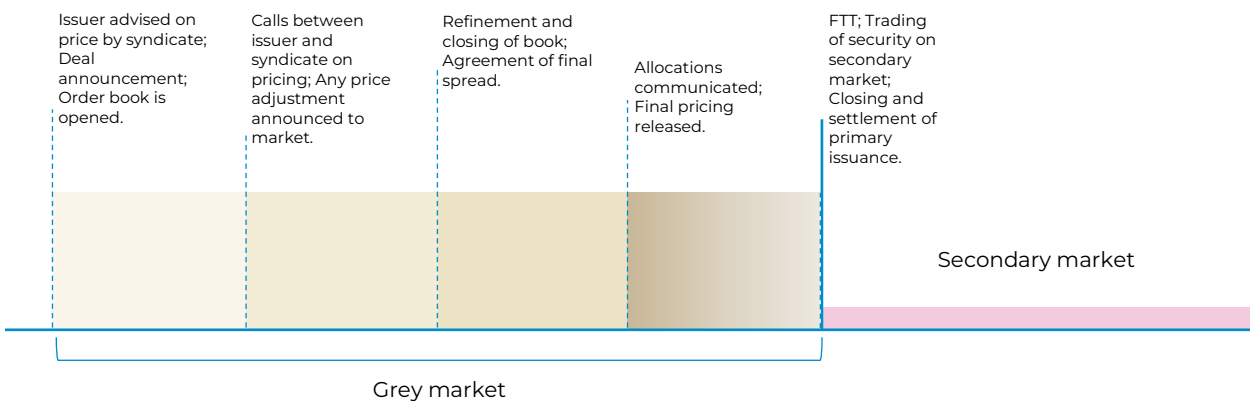
<sup>1</sup> This was highlighted by a survey conducted of FMSB Members.

## II. Context

### 1. What is grey market trading (GMT)?

- 1.1** GMT is the conditional trading of securities before they are declared free to trade (FTT) by the syndicate. GMT may begin from the point the deal is publicly announced to the market. Grey market volumes typically peak once final pricing terms have been agreed and allocations are confirmed.

Figure 1: GMT (bookbuilding process)<sup>2</sup>



- 1.2** Grey market transactions are conditional upon the successful completion of a primary market deal and the issuance of the relevant securities. Market makers will maintain internal records of GMT. Transactions are then booked and any applicable regulatory reporting takes place once the securities are declared FTT. These transactions are generally regarded as spot trades despite the fact that settlement is delayed until the bonds are declared FTT. If, for any reason, the new issuance does not close, transactions, including any grey market activity will be void.
- 1.3** GMT is distinct from any stabilisation activity. Typically, stabilisation is only permitted after pricing and should be the subject of separate records and disclosure.

### 2. Restrictions on GMT

- 2.1** Bond syndication is a private side activity and should be separated from public sales and trading by information barriers. GMT is conducted by secondary market traders on the public side of a firm (see Figure 2). Syndicate banks have historically adopted varying approaches to permitting GMT where they are also involved in the syndication. Factors influencing the practices adopted include:

- 2.1.1** the seniority of the syndication role (e.g., active bookrunner, passive bookrunner, co-manager, etc.) and, by virtue of this role, the bank's access to order and allocation information;

<sup>2</sup> This process may differ outside of UK and European markets.

- 2.1.2** whether it is a corporate or SSA issuance and the currency of the new issuance;
  - 2.1.3** if interest in the grey market is solicited (i.e., responding to a customer inquiry) or unsolicited;
  - 2.1.4** the point at which a firm may engage in GMT (e.g., restrictions may be in place at some point prior to FTT);
  - 2.1.5** volume of GMT activity engaged in and if actual or perceived downward pricing pressure could be exerted on the deal.
- 2.2** GMT is more prevalent in SSA issuances compared with other market segments and typically fewer restrictions are in place where firms are both on the syndicate and engaging in GMT in SSA transactions.
- 2.3** Typically there are no restrictions on firms participating in the grey market where the firm is not involved in the bond syndication.
- 2.4** Internal restrictions around GMT appear to date from a period where ‘retention’ structures were the core execution method in European primary markets, rather than the current ‘pot’ structure. For ‘pot’ deals, active bookrunners run an open book between them and a set fee is allocated to each syndicate member irrespective of the orders they bring to the deal. This means that firms are not competing with one another and are not incentivised to sell the new bonds at a lower price to increase their deal fees. Conversely, in a ‘retention’ structure, active bookrunners each have an allotment of bonds to sell in the primary and hence are competing with one another which could result in syndicate members undercutting each other on price in order to attract more investor interest. Restrictions on GMT were therefore intended to prevent active bookrunners from selling bonds below the fixed price reoffer in the grey market which could exert downward pricing pressure on the deal’s final pricing.
- 2.5** While the market has moved away from retention structures, the continued prevalence of GMT restrictions may be intended to manage either (i) any actual or perceived conflicts of interest which may arise due to the bank as a whole being privy to information which could inform the performance of the new securities; or (ii) concerns around GMT impacting new issuance pricing and issuer outcomes.
- 2.6** Contractual terms with the issuer may, pre-FTT, prevent syndicate banks from offering the issuer’s securities at a price less than the re-offer price.

### **3. Role of GMT**

- 3.1** Grey markets facilitate price discovery, liquidity and risk management in a security before it is formally issued.
- 3.2** Demand from investors may derive from those who did not receive, or anticipate receiving, their desired allocation in the primary market or those who wish to adjust their positions allocated during the bookbuilding process before the issuance becomes FTT. The transparency offered by GMT on trading conditions and demand for the new issuance can enable more informed decision making by investors.

- 3.3** Market makers respond to this demand and may use the grey market to hedge secondary market flows in the same or similar issuers or to gauge insights on the market conditions and investor demand for a given issuance.
- 3.4** More market makers participating in grey markets, including those where the bank is acting on the syndicate for a new issuance, can enhance the liquidity of such markets, improve the efficiency of the price discovery process and reduce price volatility once the bond is FTT. For clarity, this is distinct from stabilisation activities which provide support for the price of an initial offering for a limited time period if securities come under selling pressure. Such activities are not the subject of this Statement of Good Practice.

## **4. Risks of GMT**

Set out below are potential risks associated with engaging in GMT activity where the bank also holds a syndicate role.

### **4.1 Issuer control and pricing**

**4.1.1** Where GMT occurs between the public announcement of a deal and the release of the final pricing spread to the market, it could impact final pricing and risk disrupting the orderly issuance process or contribute to increased price volatility. As a result, issuers may be concerned that they are subject to an additional variable in the final pricing of the bond.

**4.1.2** GMT could take liquidity away from the primary book as investors source bonds in the grey market or otherwise reduce the transparency of the new issuance process as issuers will not have visibility as to who is buying or selling its bonds in the grey market. That said, once a bond begins trading in the secondary market, the issuer has no control over the ultimate holders of its securities in any event.

### **4.2 Liquidity and pricing**

**4.2.1** Grey markets can be illiquid, particularly prior to final pricing, and therefore relatively low volumes could have a disproportionate impact on the perception of secondary market valuations, which in turn may inform the final pricing spread of the new issuance. Greater participation in the grey market by banks playing a syndicate role could help alleviate illiquidity concerns.

**4.2.2** As noted in Section 2.6 above, active bookrunners may not be permitted to sell below the fixed price reoffer. However, they could be incentivised to bid up an underperforming deal in the grey market.

### **4.3 Information asymmetries and actual or perceived conflicts of interest**

**4.3.1** Actual or perceived conflicts of interest may arise where the bank is playing a role on the syndicate for the new issuance while its secondary trading desk is also active in the grey market. This is due to the firm as a whole having access to information that other non-syndicate banks and investors do not have. In practice, this should be materially mitigated by robust information barriers.

- 4.3.2** Potential conflict concerns are heightened where a bank is an active bookrunner and therefore privy to the book building process and has full access to investor orders and final allocation information (see Figure 3 below). Where the bank plays a more junior or passive role in the syndicate, its access to information is reduced and in some instances may be the same as non-syndicate banks.
- 4.3.3** Information barriers between the public and private sides of a bank mean that MNPI (material non-public information), as well as other confidential information, relating to the new issuance should be restricted to the private side.
- 4.3.4** Nonetheless, the public-side of a syndicate member may be privy to limited non-MNPI voluntarily submitted by investors, e.g., regarding outright appetite for the deal which could be used to inform GMT.
- 4.3.5** Additionally, investors typically submit orders for a new issuance to the relevant Sales coverage personnel on the bank’s public-side which are then passed on to the syndicate (see Figure 2). This means that Sales have some level of visibility of investor client orders, notably where the bank is acting as an active bookrunner. This information may, in some circumstances, also be available to Sales personnel at non-syndicate banks for example where it is voluntarily shared by investors.

Figure 2: Bookbuilding Process

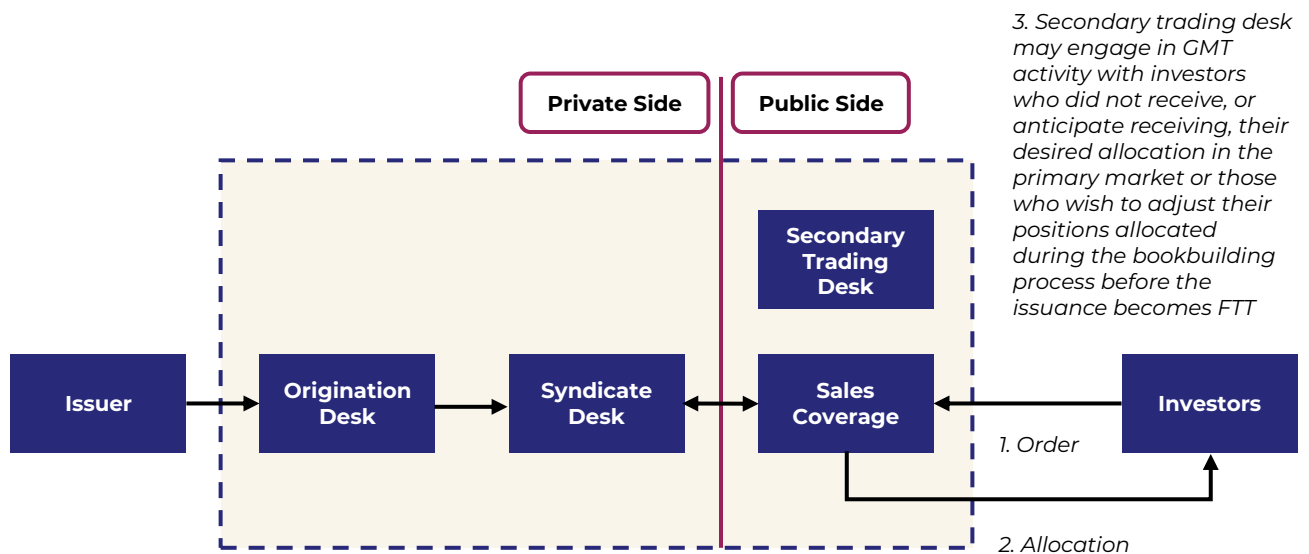


Figure 3: Information access by syndicate role

		Syndicate Role			
		Tier 1 (e.g., Active bookrunner )	Tier 2 (e.g., Passive bookrunner)	Tier 3 (e.g., Co-manager)	Tier 4 (No role)
Private-side Information Access	Full view of order book	✓			
	Full access to allocation information	✓			
	Access to allocation information once finalised		✓		
	No information			✓	✓

## 5. Glossary

Term	Definition
<b>Bookrunner</b>	The securities underwriter with responsibility for, among other things, the documentation, syndication and other activities related to the primary market issue of the issuer's securities.
<b>Free to trade (FTT)</b>	Used where there are no internal (restricted list) or external restrictions on trading so a trader in a syndicate bank working on the public side is free to solicit interest. In the primary market, bonds are declared free to trade after the transaction has been priced and investor allocations have been communicated to investors.
<b>Grey Market Trading (GMT)</b>	GMT is the conditional trading of securities before they are declared FTT by the syndicate. GMT may begin from the point the deal is publicly announced to the market.
<b>Pricing</b>	The process by which the syndicate, having allocated bonds to investors who have communicated indications of interest, determine, in conjunction with the issuer, the final terms of the deal and calculate a reoffer price for the securities to be issued. This reoffer price may be based on a reference rate, reference bond or outright yield. The reoffer price will depend on the coupon of the security which is determined in conjunction with the issuer.
<b>Primary market</b>	The market where new bonds are issued and sold for the first time. In the primary market investors purchase bonds directly from issuers or initial purchasers appointed by the issuer.
<b>Private side</b>	The side of a bank that has access to inside information.
<b>Public side</b>	The side of a bank that generally does not have access to inside information.
<b>Secondary market</b>	The market for bonds that have been issued in the primary market (including conditional trading pre- and post-FTT). In the secondary market, investors trade bonds with other investors. The investors who sell the bonds receive the proceeds, minus fees or commission payable to banks or brokers that facilitate the transaction.

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**Secondary trading desk**

The public side trading desk of a bank that may trade in fixed income securities in the secondary market once final allocations are complete and the relevant issue is priced and FTT.

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**SSA**

Collectively refers to high-grade public sector bonds. Issuers comprise sovereigns, states, provinces, supranational, agencies and related issuers with and without explicit sovereign guarantee.

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**Syndicate bank**

A member of a group of banks which jointly underwrite and distribute a new security offering in the primary market. A syndicate is not a permanent group but formed by an issuer client specifically to execute a deal in the primary market, for example where it may be more efficient for a group of banks to work together for the issuer.

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## III. Good Practice Statements

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The Good Practice Statements below set out key considerations for firms prior to deciding to engage in GMT activity in different contexts. The GPS differentiate between scenarios where a firm has a Tier 1 or other role on a syndicate due to the order book and allocation information a firm may be privy to and therefore the heightened potential conflicts, information handling or market abuse related risks. The GPS codify additional steps that a bank acting as an active bookrunner should consider prior to conducting GMT.

Each syndicate bank, in respect of its own activities only, is responsible for ensuring that any GMT is compliant with all applicable law and regulation. For the avoidance of doubt, issuer awareness of GMT activity does not alter a syndicate bank's obligations pursuant to MAR or other applicable law or regulation.

### Participation in GMT

#### Good Practice Statement 1:

Where a bank is acting as an active bookrunner for a new issuance (Tier 1) it should make the issuer aware if it intends to engage in GMT.

Prior to engaging in GMT, consideration should also be given to:

- (i) the identification and management of any conflicts of interest that could arise from such activity;
- (ii) any information that a public side trader could be privy to relating to the new issuance and the materiality of that information in the context of the transaction;
- (iii) the bank's control framework as outlined in GPS 3.

**Commentary** The bank may make the issuer aware of its approach to GMT on a periodic or relationship (rather than transaction-by-transaction) basis.

#### Good Practice Statement 2:

Prior to engaging in GMT, where a bank is acting as a passive bookrunner (Tier 2) or co-manager (Tier 3) for a new issuance, consideration should be given to:

- (i) the identification and management of any conflicts of interest that could arise from such activity;
- (ii) any information that a public-side trader could be privy to relating to the new issuance and the materiality of that information in the context of the transaction;
- (iii) the bank's control framework as outlined in GPS 3.

## Appropriate controls

### Good Practice Statement 3:

A syndicate bank engaging in GMT should have appropriate controls in place to comply with applicable regulatory or legal requirements including those relating to the management of conflicts of interest, information handling and market abuse.

**Commentary** Firms should assess whether additional controls are needed when engaging in GMT while also holding a syndicate role, particularly as an active bookrunner, considering the risks highlighted in Section II, para 4.

## Notification of FTT

### Good Practice Statement 4:

Active bookrunners should publicly announce when a new issuance is FTT where practicable.