

**RESPONSE BY THE CNMV ADVISORY COMMITTEE TO THE
EUROPEAN COMMISSION CALL FOR EVIDENCE ON PRE- AND
POST-TRADING TRANSPARENCY**

European Commission Call for Evidence (12 June 2006)

Pre- and post-trade transparency provisions of the Markets in Financial Instruments Directive (MiFID) in relation to transactions in classes of financial instruments other than shares

Question 1:

Do you have any comment on the proposed scope of the Report?

Reply:

No.

Question 2:

Do you consider this classification scheme to be sufficient for the purposes of the review?

Reply:

We consider the classification scheme as set out in the document to be sufficient for the purposes of the European Commission's call for evidence.

However, for greater clarity in the classification, we suggest it should be modified in the following terms:

1. Define a single generic group called "Derivatives" which would encompass the subgroups "bond options & futures", "interest rate swaps", "foreign exchange derivatives", "commodity derivatives", "credit default swaps", "other credit derivatives", and any other type of derivative that might be suggested by respondents to the Call for Evidence.

The reason for this suggestion is that we consider that derivatives constitute a specific group in the markets and have their own peculiar features.

Moreover, the current distribution is not entirely appropriate as some of the subgroups currently in the Credit Derivatives group should not properly be categorised as such (e.g. bond options & futures, and IRSs).

2. A new group should be defined for money market instruments (e.g. commercial paper, treasury bills, etc.).

The reason for this is that we understand that money markets are a separate class of security market with their own peculiar features.

Question 3:

Do you consider there are possible policy rationales for mandatory transparency we have not listed?

Reply:

Apart from those set out in the European Commission's document, we consider that the need for appropriate supervision of the market and the activities of its participants is another rationale for mandatory transparency. We understand that the absence of policies promoting market transparency makes it more difficult for market supervisors to discharge their duties, consisting of overseeing and monitoring to detect activities that might impair market integrity (e.g. insider dealing, front-running, sub-optimal execution, etc.).

Question 4:

Do you agree with our proposals for prioritisation of the review?

Reply:

Yes. Any proposal for investigation should start with the instruments which are largest and of greatest relative importance in the market, namely cash government bonds.

Nevertheless, if the classification is amended in line with our suggestion under Question 2, it would be necessary to give money market instruments a similar level of priority to cash investment-grade corporate bonds.

Question 5:

To what extent do you consider there to be:

- a) Observable or demonstrable problems with respect to the possible policy rationales for transparency identified above in relation to one or more of the instrument markets under review?**
- b) Evidence that mandatory pre- or post-trade transparency would solve any of those problems?**

Reply:

- a) Though we cannot say that problems are widespread, there is anecdotal evidence of, for example, sub-optimal execution in quote-driven trading

systems or in cases of internalisation which may impair investor protection and market efficiency. Academic research also supports the reasoning in favour of maximal transparency.

- b) Although there can be no conclusive evidence, the requirement for pre-trade transparency provides participants with relevant information; also, although post-trade transparency does not prevent past efficiency problems, it does help to detect them and thus make participants more aware of them.

Question 6:

To what extent could recent and upcoming technological and market developments in relation to the instrument markets under review:

- a) Contribute to a relatively inexpensive extension of mandatory transparency?**
- b) Render mandatory transparency unnecessary?**

Reply:

- a) One cannot assume that mandatory transparency is cheap, even with modern technology. Organised markets are generally better able to provide transparency more cheaply. The dispersal of trading among multiple platforms raises the problem of consolidating the information, which is particularly relevant in pre-trade transparency (how to get it and at what price). Without wishing to go further into this area, we believe it is clear that the full benefits of transparency are not obtained without consolidation. Post-trade infrastructure should play an important role in this respect.

In any case, it is necessary (though difficult) to make a cost-benefit analysis of mandatory transparency and "spontaneous" transparency in fragmented markets.

- b) No matter how advanced the technology, transparency takes longer if it is not mandatory.

Question 7:

To what extent are non-equity financial instruments different from equities so that lower levels of mandatory transparency in those markets may be justified?

Reply:

Lower levels of mandatory transparency may be justified in the case of non-equity financial instruments if they are relatively non-standard instruments whose liquidity is dispersed among many types of issues, issuers, etc. In particular, because of the nature of the asymmetries in information and execution, influenced by the size of the trades, public debt markets are intrinsically biased towards fragmentation.

Although transparency normally favours liquidity, there are cases where a given level of transparency does not favour liquidity because certain investors are not willing to disclose their orders publicly and will seek alternative, less demanding systems. The optimal solution would be to find a balance between equal transparency requirements for all systems trading the same asset types, on the one hand, and the goal of maximum liquidity, on the other.

Question 8:

What data sources do you consider relevant to the issues you have raised (if appropriate, cross-refer to your answers below)? Would you or your organisation be prepared to produce any relevant data if necessary?

Reply:

The sources listed in the Annex, particularly the IOSCO Technical Committee Report, are relevant. If anything, the members of this Advisory Board, rather than the Board itself, would be the ones in a position to provide data in this connection.

Question 9:

Are there academic or institutional papers or ongoing work that should be considered in preparing the Report not included in our bibliography?

Reply:

Martínez-Resano, José Ramón, 2005, "Size and heterogeneity matter. A microstructure-based analysis of regulation of secondary markets for government bonds". Banco de España. Documentos Ocasionales No. 0501.

Alonso Alonso, Enrique, and Sastre Corchado, Galo Juan, 2003. "Transparencia y principio de mejor ejecución". Comisión Nacional del Mercado de Valores. Monografías No. 2. June 2003.

Question 10:

What conclusions do you draw from the existing academic debate and the ongoing work being conducted by interested parties?

Reply:

The main conclusion is that the fixed-income market (government and corporate bonds) is structurally different from the equities market, and both differ structurally from the derivatives market. Therefore, ideas for increasing transparency may be used if adapted appropriately.

It should be borne in mind that the debate may be biased by special interests.

Question 11:

In your view, how applicable is the academic or institutional literature concerning transparency in the cash equities markets to the present discussion?

Reply:

It is applicable provided that the differences are taken into account.

Question 12:

What similarities, and what differences, are there between US and EU markets that should be borne in mind when seeking to draw inferences from the TRACE experience in the US?

Reply:

TRACE is interesting to observe but not necessarily to replicate. The Chairman of the SEC once said that the system did not seek to replicate the equity system in the case of fixed-income but, rather, to protect investor interests by adapting the requirements to the different way in which the fixed-income markets work.

Question 13:

To the extent that you have identified problems or believe that others might do so, do you agree that only EU-level action would be appropriate in the present case?

Reply:

Yes. Because the goal is to create a single operating environment in Europe. Without Europe-wide coordination, the time required to attain the objectives would vary widely in terms of area and product.

Question 14:

If you have identified problems or believe that others might do so, to what extent do you consider those problems would disappear as a natural product of market evolution in the short-to-medium term?

Reply:

They are unlikely to disappear.

Question 15:

In respect of both pre- and post-trade transparency, are the four options the right ones to consider, and in particular should other options be considered?

Reply:

Yes, they are the right options. However, with regard to pre-trade transparency, a "full mandatory MiFID-like system" could be considered if the liquidity features of corporate fixed-income products are taken into account.

Question 16:

Would you, in light of your answers to the other questions, favour any the four options in relation to pre- and post-trade transparency (or another option you might propose for consideration) in respect of transactions in any of:

- **Cash government bonds;**
- **Cash investment-grade corporate bonds;**
- **Cash high-yield corporate bonds;**
- **Asset-backed securities;**
- **Credit default swaps, interest rate swaps and bond futures;**
- **or**
- **Any other financial instrument you consider relevant?**

Reply:

With regard to pre-trade transparency, see previous reply.

With regard to post-trade transparency, the fourth option for all product classes.