# 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
# Response to the Commission´s Call for Evidence

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Deutsches Aktieninstitut e.V. is the association of German exchange-listed stock corporations and other companies and institutions which are engaged in the capital markets development. Its most important tasks include supporting the relevant institutional and legal framework of the German capital market and the development of a harmonised European capital market, enhancing corporate financing in Germany and promoting the acceptance for equity among investors and companies.

## Introduction

The Deutsches Aktieninstitut welcomes the opportunity to comment on the issue of transparency within the scope of the Report regulated by Art 65 of MiFID. Considering all markets of financial instruments other than shares the most important one is the bond market. Therefore the Deutsche Aktieninstitut will concentrate on it when commenting on the Commission´s call for evidence.

The importance of the European bond market is obvious. Bonds count for two-thirds of the total amount of securities outstanding. The European market is dominated by government bonds and bonds issued by financial intermediaries. By contrast US-bond market has about the size of the stock market and the proportion of bonds not issued by the non-financial corporate sector is much larger[1]. Given its importance the European bond market should operate

[1] Centre for European Policy Studies, European Corporate Bond Markets: transparency, liquidity, efficiency, 2006, p. 2

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efficiently. Efficiency (high liquidity and low transaction costs) is – among others – linked to market transparency.

To enhance efficiency in the stock market the provisions of pre- and post-trade have been included in the Directive on Markets in Financial Instruments (2004/39/EC, MiFID). Whether the pre- and post-trade transparency provisions will have the desired effects on the stock market is still unknown because the MiFID is not implemented yet. Now the question is whether transparency regulation regarding the bond market will enhance the efficiency and liquidity of it.

**Question 1: Do you have any comment on the proposed scope of the Report?**

"The provisions of the Directive concerning pre- and post-trade transparency obligations" (Art 65 MiFID) have been concretised by the proposed implementing measures. Therefore they should also be included in the discussion whether the transparency system of MiFID should be extended to other non-equity securities. There is furthermore no need for extending the MiFID transparency system to all other non-equity securities in the same way. Different securities markets need different transparency solutions.

**Question 2: Do you consider this classification scheme to be sufficient for the purposes of the review?**

Yes, the classification seems sufficient.

**Question 3: Do you consider there are possible policy rationales for mandatory transparency we have not listed?**

No, in our opinion the possible policy rationales are listed.

**Question 4: Do you agree with our proposals for prioritisation of the review?**

Yes. The importance of the bond market makes it clear that it should be on the top of the list.

**Question 5: To what extent do you consider there to be:**

a. **Observable or demonstrable problems with respect to the possible policy rationales for mandatory 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?**

We do not have identified problems with respect to the possible policy rationales for mandatory transparency (see question 7).

**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?**

Right now there is a rapid technological change in the security markets. The development of new technology will enable the market participants to collect and disseminate transaction data in an unprecedented amount. Whether these technologies will make the achievement of transparency data inexpensive can perhaps be answered after the implementation of MiFID. The transparency provisions of MiFID will be a test to see how the stock market will cope with all the information set free by the pre- and post-trade provisions and at what costs.

If all the new IT is in place and working new possibilities will open up to bond market participants how to use these facilities in order to make the bond markets more transparent by disclosing more transaction data.

**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?**

The microstructure of the European bond market is very different from the stock market. While stocks are normally traded on electronic venues quotes in bond markets are posted by professional intermediaries and bonds are mostly traded over-the-counter. This different way of trading results in a more bilateral, personal communication in bond markets.

The liquidity in the bond market is lower than in other markets because sometimes large fractions of an issue are bought by institutional investors and hold until maturity.

Another special aspect is that retail clients are a lot less active in the bond market than in the stock market.

In general the government and corporate bond markets seem to work rather satisfactorily and fit to the needs of most of their participants[2]. By imposing mandatory transparency rules, the microstructure in these markets would be disturbed. Mandatory transparency provisions increase the costs of the transactions. Additionally, liquidity would possibly dry up if the transactions would be made public by mandatory transparency requirements because the positions taken by the dealers would be exposed. This information could be used and taken advantage of by other market participants. The efficiency of the bond markets would suffer, if mandatory requirements are to be introduced.

Especially in the bond market it should be pointed out that the policy rationale "investor protection" does not have the importance as in other markets because in this market the vast majority of investors are institutional investors who do not need high protection level. Therefore there is no real need to impose transparency provisions in the bond markets at all.

[2] Centre for European Policy Studies, European Corporate Bond Markets: transparency, liquidity, efficiency, 2006, p. 6; Centre for Economic Policy Research, European Corporate markets: transparency, liquidity, efficiency, 2006, p. 67;

**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?**

Not knowing which problems others might have identified in the bond markets we can not tell whether the EU-level might be the right one or not.

**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?**

The way of personal trading in the bonds markets might lead perhaps to a certain opacity in these markets. But some degree of opacity seems necessary to give an inducement to dealers to supply liquidity and pre-trade information[3]. If however, the technological developments will make even more progress, the chances are good for an electronic platform, which could be an answer to the existing way of trading in the bond markets. If the bond markets do not work efficiently anymore, the markets will find a solution.

In any case the results of the application of the pre- and post-trade provisions of MiFID should be awaited before imposing new transparency provisions on the bond markets.

**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?**

The four options listed in the Commission`s consultation paper are the right ones.

[3] Centre for European Policy Studies, European Corporate Bond Markets: transparency, liquidity, efficiency, 2006, p. 6; Centre for Economic Policy Research, European Corporate markets: transparency, liquidity, efficiency, 2006, p. 4;

**Question 16: Would you, in light of your answers to the other questions, favour any of 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?**

Regarding the bond markets the option right now is to change nothing and await further developments in technology and in the structure of the markets themselves.