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RESPONSE TO CALL FOR EVIDENCE

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

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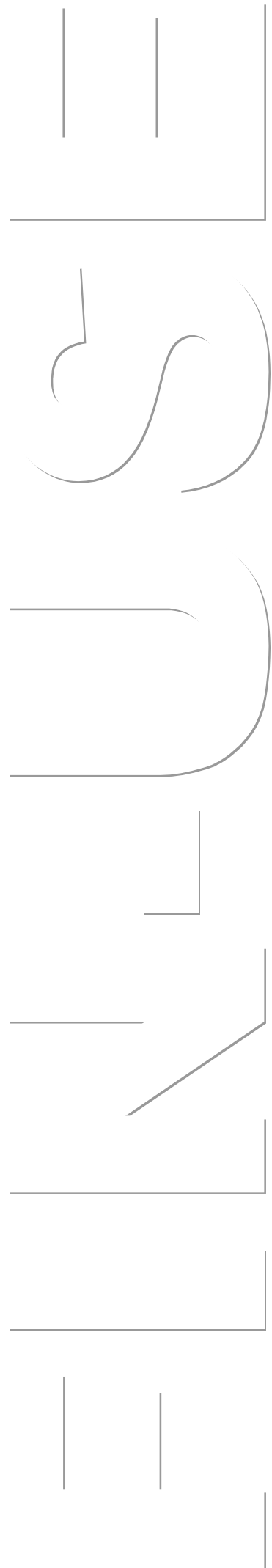
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PRELIMINARY REMARKS

FIN-USE welcomes this call for evidence on the adequacy of the level of pre- and post-trade transparency in classes of financial instrument other than shares as the first stage in the process of public consultation to prepare the Report required by Article 65 (1) of MiFID. We agree with the consultation document that emphasizes the importance of including “consumer and investor input in this public consultation” (p. 2). It has been assumed by some that this is a highly technical topic which should only be for industry to discuss but this is also clearly an important issue for retail investors.

The Report recognises the appetite of retail investors for financial instruments different from shares. In fact, there is a growing tendency internationally for retail investors participating in bond markets. This participation could be direct or indirect, through pension funds and other institutional investors.

In some EU members countries however, such as the UK, there is limited participation of retail investors in non-equities markets. We are in favour of the development of the non-equities markets facilitating direct participation of retail investors, thereby giving them new investment opportunities.

A number of issuers have expressed their interest in retail participation in the bond market and they see retail participants as an important investor group for their bonds. But to develop a retail bond market we need appropriate transparency in the market.

In order to open these non-equities markets to retail investors we consider to be necessary new transparency mandatory provisions. To invest in non-equity financial instruments retail investors must know not only how these markets operate but also they need to receive information about the products and the transactions. Retail investors have access to transaction information in the equities markets but it is very limited in the bond markets. One of the main reasons that prevent retail investors from participating in the bond market is the fact that it is difficult for them to gain access to market information. It is therefore important to improve transparency in non-equities markets if the market is to be successful in relation to retail investors’ participation.

This call for evidence is an opportunity to ascertain that investors needs’ on transparency obligations to transactions in non-equities financial instruments are similar in nature to those corresponding to transactions in shares and, in that respect, whether there is a need to at least extend equity market transparency to the non-equities markets.

We think that it is crucial to protect retail investor by extending the scope of the provisions of the MiFID concerning pre and post-trade transparency obligations to transactions in classes of financial instruments other than shares.

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RELATION TO TRANSACTIONS IN CLASSES
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This response is mainly dedicated to extending the MiFID's transparency provisions of equities markets to the retail non-equities markets, from the point of view of protecting investors.

PROPOSED PROJECT DESIGN: SCOPE OF THE REPORT

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

We agree on the general proposed scope of the Report to adapting the equity market regime to the special characteristics of bond markets.

However we propose that there should be a distinction made between bonds and other non-equity financial instruments that can be purchased or sold by retail investors. Furthermore, we also propose that the Report should have two separate chapters. One dedicated to the retail non-equities markets, focusing on investor protection, and the other chapter on the institutional non-equities markets, addressing market efficiency.

Additionally, we need more research to have a clear picture of retail participation in different non-equities markets. This should provide evidence as to how to extend equities market transparency to retail non-equities markets.

CLASSES OF INSTRUMENTS

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

The scheme could be useful as a basis to design transparency regulations in the professional market. In the retail market, we only propose one option in terms of a mandatory transparency system, that is, applying the scheme of MiFID transparency provisions for equities markets.

Although there is a broad diversity between the non-equities markets and the market for shares regarding the role of different participants, from the point of view of investor protection, transparency is a common and important objective of both markets.

It is not feasible for retail investors to comprehend a transparency system with at least eighteen categories of financial instruments. There must only be one transparency system for financial instruments that can be traded by retail investors.



FOCUS AND PRIORITISATION

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

We agree with the policy rationales for mandatory transparency of investor protection and market efficiency. These rationales were already identified in MiFID as: “the two-fold aim of protecting investors and ensuring the smooth operation of securities markets” (recital 44 of MiFID). Technological developments are an appropriate tool to achieve these two main objectives.

To facilitate retail investors’ participation in bond markets the improvement of market transparency must be a prime objective. There is evidence of transparency deficiency within the secondary bond market.

We are in favour of post-trade mandatory transparency to ensure that retail investors can access to relevant information, enabling them to revalue their portfolios and verify that they have receive best execution from their intermediaries.

The suitability requirements and the best execution regime introduced by MiFID are designed to afford protection to retail investors as a whole with transparency measures. With complex non-equity financial instruments, these measures can fulfil a complementary role.

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

We support the focus on those markets with retail investor participation where there are investor protection concerns. But we appreciate that the greater appetite of retail investors for some complex financial instruments invariably depends on the strategic decision-making of investment banks and other intermediaries.

We need research and data on direct and indirect participation of retail investors in bonds and other non-equities financial instruments to determine which markets have the highest retail participation, including UCITS markets.



DISCUSSION: PROBLEM IDENTIFICATION

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?

There is insufficient research on problems of retail investors in non-equities markets. Nevertheless, we consider that there is evidence of the problems of investor protection due to the lack of transparency in the asset-backed securities and corporate bonds markets.

b. evidence that mandatory pre- or post-trade transparency would solve any of those problems?

Post-trade mandatory transparency could help to solve those problems. With timely price information, retail investors can refer to them in evaluating a potential transaction. Also, supervisors need post-trade information to evaluate how intermediaries are addressing the best execution regime.

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?

Yes, technological developments contribute to the inexpensive extension of mandatory transparency.

b. render mandatory transparency unnecessary?

No, mandatory transparency is necessary to secure investor protection in bond and other non-equity markets. The evidence suggests that industry is reluctant to change the bond markets structure through more transparency measures, to protect investors and enhance market efficiency. We propose an open discussion with consumers, issuers, supervisors and other stakeholders trying to change this attitude similarly to what has been carried out in the US.

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?

**RESPONSE TO CALL FOR EVIDENCE
PRE- AND POST-TRADE TRANSPARENCY PROVISIONS OF MIFID IN
RELATION TO TRANSACTIONS IN CLASSES
OF FINANCIAL INSTRUMENTS OTHER THAN SHARES**



From the point of view of investor protection, non-equity instruments are not different from equities. Bonds and other complex financial instruments are only new alternatives to investors.

However, they are more complex and the investor needs complementary protection measures. Financial education has an important role to play.

Many retail investors do not understand how the bond markets work and the associated risks in this market. For example, there is a lack of understanding of the relationship between bond prices and interest rates. Issuers and investment banks do not help consumers in their understanding of the market, using for example, the term «bond» for a wide variety of financial instruments. We are of the opinion that it is necessary to improve investors' financial culture by widening emphasis from purely equity markets to a more open financial instruments culture.

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?

We consider that it is relevant to obtain data on retail participation on bonds and other non-equities markets. It is important to know the extent to which retail investors participate in different bonds markets and what prevents them from participating in some non-equities markets.

RELEVANT ACADEMIC AND INSTITUTIONAL WORK

Question 9: Are there academic or institutional papers or ongoing work that should be considered in preparing the Report not included in our bibliography?

The Report's Bibliography appears to be a complete and useful help in appreciating the transparency problems in the bond markets. It would however, be helpful, for the sake of clarity, to differentiate industry or financed by the industry reports from Academic, Supervisors and other independence sources.

From the point of view of investor protection, the Report of NASD's Corporate Debt Market Panel issued in September 2004 could be added as it includes important recommendations focusing on the retail aspects of bond markets.

Question 10: What conclusions do you draw from the existing academic debate and the ongoing work being conducted by interested parties?

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PRE- AND POST-TRADE TRANSPARENCY PROVISIONS OF MIFID IN
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OF FINANCIAL INSTRUMENTS OTHER THAN SHARES**



From the existing academic debate, we conclude that in the bond market greater transparency improves market efficiency and investor protection, similarly to that experienced in the equity markets. The increase of transparency reduces transaction cost and it does not have a negative impact on liquidity. Lessons from US TRACE system indicate that there is no evidence of a trade off between transparency and liquidity.

We conclude that the availability of timely price information not only protects retail investors, but it also promotes fair and efficient markets. However, EU Industry is reluctant to admit this evidence and has prepared *ad hoc* papers trying to justify the actual opacity of the non-equities markets.

Question 11: In your view, how applicable is the academic or institutional literature concerning transparency in the cash equities markets to the present discussion?

General academic or institutional literature concerning transparency in the cash equities markets is a good point to start in the debate but it is necessary to develop specific literature for non-equities markets, particularly on investors' protection issues.

From the consumers' perspective, there are common objectives of transparency between cash equities markets and non-equities markets. However, they have different structures which need to be taken into account before extending all mandatory transparency provisions of equities markets to non-equities markets.

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?

More research is needed in order to ascertain retail participation in the EU non-equities markets and whether this participation is lower than the US markets and the reason for this.

There is an international tendency to increase retail participation in non-equities markets. With important retail participation in non-equities markets, US TRACE experience could be very useful. This experience should be borne in mind by CESR to develop and interpret new mandatory transparency provisions.



ADDITIONAL FILTERS IN PROBLEM IDENTIFICATION

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?

We agree that EU-level action would be appropriate in order to extend transparency mandatory provisions to non-equities markets, as EU-level action is also appropriate for equities markets.

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?

We believe that market evolution and industry initiatives are not enough to develop a transparent retail non-equities market with high standards of investor protection. To open the bond and other non-equities financial instruments to retail investors it is necessary to introduce EU legislation with the aim of extending equities market transparency regime of MiFID to non-equities markets.

**OPTIONS FOR DISCUSSION:
PRE-TRADE TRANSPARENCY, POST-TRADE TRANSPARENCY**

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?

We are in favour of a post-trade transparency mandatory MiFID-like system.

However, first, it is necessary to distinguish between retail and institutional non-equities markets, and then to consider how to protect retail investors through mandatory transparency provisions. US TRACE experience shows us that post-trade transparency measures could result in satisfactory levels of investors' protection. Pre-trade transparency, as quoted mandatory information, could have a lower effect on consumers' side as it is more concerned with overall performance of the instrument. Additionally, the implementation of pre-trade transparency measures requires a change in the market's structure. Having an open market for retail investors, could be useful for investor protection and market efficiency to introduce some limited pre-trade transparency provisions.

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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?*

We are in favour of giving priority to post-trade transparency mandatory provisions in those non-equities markets with relevant retail participation. Nevertheless, it is necessary to obtain data of retail participation, before focusing on a special market. Then we could distinguish between retail and institutional markets and focus on transparency regulations for the retail markets.

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