

**Q1. Do you have any comments on the proposed scope of the report?**

The proposed scope of the report is appropriate given the requirements as set out in Article 65 of MiFID. What was pleasing was the recognition that a one-size-fits-all approach for analysing fixed-income instruments is inappropriate given their non-homogeneity in terms of structure, nature of instrument or investor base.

**Q2 Do you consider the classification scheme to be sufficient for the purpose of the Review?**

The level of granularity appears sufficient for the purpose of the review. However, the categorisation of transactions under credit derivatives gives the impression of a tightly defined homogeneous set of instruments which is not the case.

**Q3. Do you consider there are possible policy rationales for mandatory transparency we have not listed?**

The only policy rationale for mandating transparency is the identification of a market failure and evidence that mandatory price transparency is the most appropriate tool (as supported by rigorous cost benefit analysis) would solve that specific market failure.

The Commission is right to consider investor protection alongside market efficiency as being policy rationales for mandatory price transparency. However, it needs to be remembered that investor protection is often better furthered by other policies such as investment advice, conflicts of interest, best execution, information to clients etc, and that greater mandatory transparency would had made no difference to recent situations where European investors lost money through investing in bond markets, such as in Parmalat.

The consideration given to technological developments is welcome, particularly given the large number of recent technological improvements have increased price transparency, for example Markit, TradeWeb and Market Axxess.

**Q4. Do you agree with our proposals for prioritisation of the review?**

It is important that the review prioritises products. Not all classes of fixed income products or their markets are uniform and retail investors' exposure to those products or markets in Europe is extremely low.

There is no mention of the market efficiency policy rationale in the Commission's prioritisation of the review. This area is of crucial importance and should be a prominent consideration.

**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?**

To the best of our knowledge we do not consider that there are observable problems of a kind that would justify the mandatory pre- or post-trade price transparency.

**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?**

Mandatory price transparency is presently unnecessary given the absence of a market failure. Given the direction of future market developments (greater competition, more trading platforms competing at offering more and more information) this will render mandatory price transparency even more unnecessary in the future.

Europe's fixed income markets have tailored their transparency requirements to the market needs. All of the markets under review are experiencing rapid technological and market growth and development, including, where appropriate, an increasing degree of pre- and post-trade transparency. The recent evidence from CEPR does not support a case for mandatory (i.e. regulatory driven) transparency, but also raises the real potential that mandatory transparency could be harmful to the cause of well-functioning capital markets in Europe.

European industry is currently faced with the significant challenge of ensuring that technological systems are compliant with MiFID by November 2007. Not only is it too early to tell how far technological 'add-ons' would render the extension of MiFID pre- and post-trade transparency relatively straightforward and inexpensive, it should be noted that while equity markets are mostly exchange-based and electronic, non-equity markets due to their more bespoke nature are characteristically OTC and still largely voice trading so the costs incurred for transparency provisions would be on a much higher scale.

In addition to considering the costs of developing new technology, other costs, such as liquidity becoming more expensive for clients should be taken into account.

**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?**

There are a number of major distinctions between equity and bond markets that have major consequences for price transparency.

The equity market operates predominantly on an agency basis whereas the bond market operates predominantly on a principal basis. In other words, bond dealers sell securities from and buy securities into their trading portfolios. Many dealers provide liquidity to their customers on an at-risk basis i.e. they buy bonds from them

even though they do not have an ultimate buyer to whom to on-sell the bonds at the time they enter into a transaction. During a bond's more liquid trading period, dealers will sell bonds to investors without necessarily having a corresponding supply of securities to cover the resulting short position. Therefore, mandatory transparency in a market that operates on a principal basis will harm liquidity, as market-makers who take on at-risk positions will be forced to increase their liquidity charges in order to make up for losses incurred from disclosure of their inventory to the market at large. These charges will be passed along to the client.

Buying and selling of equity shares takes place almost exclusively in the secondary markets. However, most investors in bonds buy and hold to maturity and primary market purchases and redemptions of bonds account for the significant part of the buying and selling in the bond markets.

Bonds usually have a maturity date on which the principal is repaid. The bondholder can wait for his investment to mature to get the principal amount invested back. An investor holding equity wanting to retrieve his investment has to rely solely on the secondary market, which makes the issues of investor protection from abusive trading practices and trading transparency more critical.

It is much more difficult for retail customers to understand bond markets than equities. Faced with investing in equities, all a retail customer needs to know is the share price and when the dividend is due. A greater amount of information is needed when deciding to purchase a corporate bond. This means that the last traded price (or any price) maybe a poor indicator of the value of a bond at any given time. The bond price is one piece of information, but in order to judge how the instrument is likely to perform, the investor also needs to know information on the price of government bonds, the overall level of interest rates and what is expected to happen to future interest rates, credit conditions, shifts in default risks, etc.

In addition, bonds are more varied in their structures, even across bonds issued by a single issuer. For example, government, investment grade, high-yield and asset-backed securities. Bonds have a wider variance in liquidity from the most liquid to the least, with a much longer tail of less liquid issues. Bonds also trade in far larger transaction sizes; tend to have much larger denominations; have a lower direct participation by retail investors; are more likely to trade off-exchange; are more likely to have a listing outside the jurisdiction in which the issuer is located and are only actively trade in the first few months (or even weeks) following issue and therefore trade much less frequently thereafter. In contrast shares trade on a daily basis whereas, except for certain benchmark issues, Bonds are therefore more likely to be "buy and hold" assets. Market making remuneration in equities is based on commissions while bond market making remuneration is based on the bid-offer spread.

**Question 8. What data sources do you consider relevant to the issues you have raised? Would you or your organisation be prepared to provide any relevant data if necessary?**

The data sources listed by the Commission Services and the CEPR studies detail the data sources. All of these sources are publicly available. Goldman Sachs International would be happy to discuss any requests for relevant data to assist the Commission Services.

**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 recent work by the FSA is not included in the bibliography.

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

The Commission Services should call on market practitioners to supplement the conclusions that can be inferred from academic research.

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

The distinct differences between equity and fixed income markets means that this literature is not directly applicable (see also answer to question 7).

**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?**

In general, the US corporate bond market is less competitive than European markets. European markets already have tighter spreads than the US, and there are fewer dealers in the US market. Europe has twice as many corporate debt underwriters as the US, and more than three times the number of primary dealers in government securities. Additionally, 62 percent of the e-trading platforms are in Europe. Direct retail investment and participation in secondary trading is much lower in the European market. It is also probable that retail investors in the US obtain worse prices relative to wholesale market prices than do retail investors in Europe. Europe has much greater pre-trade transparency than the US corporate bond market. EU bond market turnover is one-third of that in the US, despite the fact that the EU has a higher level of issuance. Bonds also trade in smaller sizes in the EU market than in the US.

Given these differences, any application of TRACE like requirements to EU corporate bonds would have different implications for Europe's corporate bond market.

**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?**

As a principle, we should only regulate where there is a clear market failure. No market failure relating to bond market transparency has currently been identified. As a consequence, Goldman Sachs International does not believe that regulatory intervention is appropriate or necessary. A mandatory transparency regime may be counterproductive, reducing liquidity while failing to provide retail investors with suitable protection tailored to their grasp of the complexities of fixed income markets.

Should such a market failure become apparent through credible economic evidence, the option of regulation should only be considered where:

- (1) it can be demonstrated that competition, technological innovation, and market forces would be inadequate in addressing that market failure over a reasonable period; and
- (2) a clear benefit targeting investor protection is attainable.

If there is doubt that regulation would provide a net benefit, then regulatory action should not be pursued. However, if it is ultimately concluded that a market failure exists and is capable of being addressed by mandatory transparency, then a pan European approach may be preferred.

**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?**

Goldman Sachs International has not identified any problems. Fixed income markets have always shown a capacity for innovation and flexibility. As these markets continue to evolve then transparency will adapt accordingly.

**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?**

**Question 16. Would you in light of your answers to the other question, favour any of the four options in relation to pre- and post-trade transparency (or another option you might propose for consideration) in 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; Any other financial instrument you consider relevant.**

Goldman Sachs International favour the no-change option for both pre - and post-trade transparency since the market is already characterised by low spreads,

provides adequate price information, especially through electronic trading platform dissemination and is characterised by a high degree of competition within the market.

Finally, we advocate caution in comparing the equity and fixed income markets and seeking to simply apply experience of one to the other.