ICAP

15 September 2006

David Wright
Director, Financial Services Policy and Financial Markets
DG Internal Market
Avenue Cortenbergh 107
Brussels 1049
Belgium

BY ELECTRONIC MAIL

Dear David

Re: MiFID pre- and post-trade transparency provisions in relation to non-equity transactions

Enclosed is ICAP's formal response to DG Internal Market's Call for Evidence regarding "Pre- and post-trade transparency provisions of the MiFID in relation to transactions in classes of financial instruments other than shares" ("MiFID Article 65 (1) review"), published on 12 June 2006.

ICAP is grateful for the opportunity to contribute to the Commission's reflections at this early stage of work regarding the MiFID Article 65 (1) review.

Overall ICAP remains highly skeptical regarding the regulatory rationale for extending MiFID's pre- or post-trade transparency provisions to non-equity financial instruments. There are fundamental differences between equity and non-equity financial instruments – and therefore the effects of externally-imposed transparency on these markets will be fundamentally different.

All dimensions of the OTC environment are more subtle, sophisticated and in a state of dynamic evolution than the listed exchange environment. It is difficult to see how any general rules could be applied without distorting these markets which are critical to Europe's ability to manage financial risk and fund economic growth.

We remain at the disposal of the Commission Services to provide additional input as its work proceeds and look forward to discussing these matters further in the near future.

Yours sincerely

Godfried De Vidts
Director of European Affairs
ICAP Plc
2 Broadgate
London EC2M 7UR

Copy: Michael Murray, Nathalie de Basaldua, Sabino Fornies, Laurence White, Jiri Krol
Encl.

ICAP plc
2 Broadgate
London
EC2M 7UR

Tel: + 44 20 7000 5000
Fax: + 44 20 7000 5975

Registered in England 3611426

Pre- and post-trade transparency provisions of the MiFID in relation to transactions in classes of financial instruments other than shares

Response to DG MARKT Call for Evidence of 12 June 2006

1. ICAP Group

ICAP is the world's largest interdealer broker (IDB), intermediating more than **EUR 7**80 **bn** notional value per day in financial markets across Europe, the US and Asia. Headquartered in London, and with offices in seven European countries, Europe represents the largest source of income for ICAP's global business.

ICAP's specialist intermediary broking service is provided to commercial and investment banks in the wholesale financial markets. As an "inter-dealer broker" ICAP works in these markets to enhance liquidity by matching buyers and sellers so that trades can be executed at best prices by its banking customers. Banks pay a commission when they use an IDB to complete a deal. ICAP offers banks significant economies of scale in price discovery by having a number of staff covering each product and is in constant contact with a range of counterparties. In many markets ICAP operates as an agent or "matched principal broker" providing banks with the opportunity to preserve pre- and post-trade anonymity by settling trades via the IDB. In such cases ICAP simultaneously buys from one of the underlying counterparties and sells to the other in order to facilitate this.

There is a growing demand for electronic broking of liquid products, which is complementary to voice broking of more bespoke or less liquid products. The majority of the markets in which ICAP operates rely on, and will continue to rely on, voice broking skills to provide liquidity (tradable price availability) to the wholesale markets. Electronic broking naturally complements voice broking across associated asset classes or sub-sets of these asset classes and in some markets ICAP's service combines voice and/or electronic access to a common pool of liquidity.

2. OTC markets

2.1 European market context

ICAP provides interdealer broker services in OTC markets for fixed income securities, equities, money market products, foreign exchange, energy, credit and equity derivatives. These markets are used by financial institutions and others to manage their exposure to risk, including credit, interest rate and exchange rate risks.

These markets have grown significantly in recent years due to a number of factors:

- Volatility in medium term interest rates
- Increased allocation of regulatory capital for trading and position taking by the banks and their hedge fund clients
- Demand for significant deficit financing in many of the G7 countries
- Increased issuance in the corporate bond and mortgage backed securities markets
- Shifts in foreign exchange rates and
- Changes in the demand for commodities such as oil, coal and gas.

The strong growth exhibited in the credit and the interest rate markets clearly underscores the benefits these markets provide as financial risk management tools. The credit default swap (CDS) market, for example, has been effective at redistributing risk away from the banking system to other institutions such as insurance companies and pension funds, facilitating a transfer of credit risk out of the banking system.

Due to the fractured and diverse nature of bond issues across the EU (which represents the incoherence in the cost of borrowing and the benchmarking of creditworthiness), the European interest rate derivatives and CDS markets are wider and more liquid than the markets in either government

bonds or corporate bonds. These products are therefore much more widely utilised by professional investors than equivalent products in the USA[1].

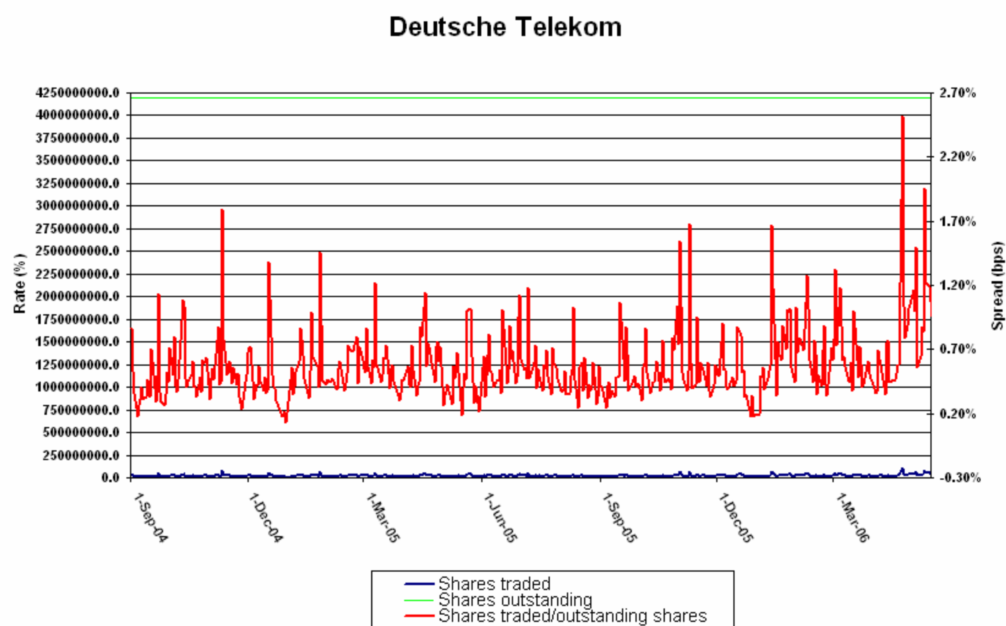
Although a very significant portion of Europe's bond trading occurs via London, this geographical centre of gravity for Europe's secondary market should not ignore the fact that the market is populated with issuers, dealers and investors located pan-European, even worldwide. Several hundreds of billion Euro notional value of bond transactions including outright cash bonds, basis trading and repo are amongst many other products traded by our clients throughout the European Union each day.

2.2 Fundamental differences - equity vs non-equity financial instruments

A listed share represents only one economic measure – the *anticipated* economic performance (and corresponding increase / decrease in value) of the company that issued the share.

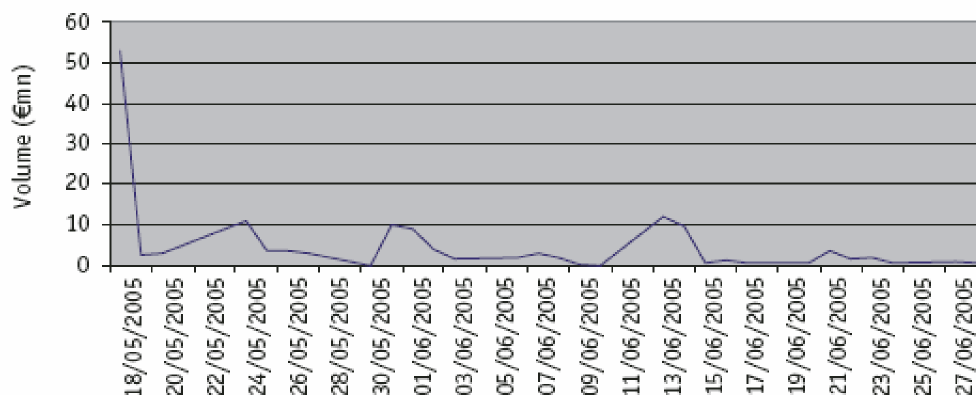
The issuance of bonds, by way of analogy, is also a financing technique, but the variations in the terms and conditions of bonds means that they do not represent a single, coherent asset class. Bonds are transferable by nature, but can be shaped for a particular investor market (by issuing tradable lots in a minimum size) or limited by terms (such as limiting trading or investor location; most USD denominated Eurobonds for example). Bonds are also variable by coupon, maturity, currency, issuer credit quality, convertibility, underlying asset performance and therefore yield.

As a comparative example the range and diversity of bonds in Europe combined with the "short life liquidity"[2] means that quality flow into and across different bond issues is dynamic and variable. As illustrated in the graphs below, this can be strongly contrasted with shares, which have no maturity and retain intrinsic tradability for the life of the issuer.

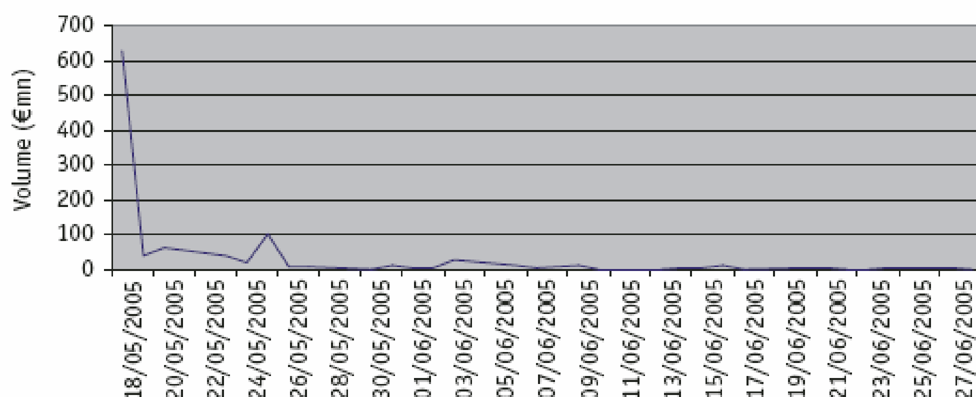


Data Source: Deutsche Telekom

[1] A point noted by Casey and Lannoo in "Europe's Hidden Capital Markets", CEPS 2006
[2] A feature noted by the FSA in its Discussion Paper DP05/5: Trading transparency in the UK secondary bond markets



Ref: FSA DP05/5: Trading transparency in the UK secondary bond markets
Data Source: ICMA



Ref: FSA DP05/5: Trading transparency in the UK secondary bond markets
Data Source: ICMA

Due to the more focused nature of equity markets (considerably fewer instruments) there can be a more consistent capital commitment. To illustrate this point, Euronext has in excess of 1.300 shares listed while there are an estimated 250.000 bonds on issue in the EU.

Due to the prevalence of low interest rates in recent years, in particular in Europe, borrowing has been comparatively cheap for entities wishing to raise funds. There has been an increase in the placement of issues and an increase in the maturity of issues, which in both cases has had a tendency to reduce trading liquidity and to increase bid/offer spreads. In order to hedge portfolio exposures the banks and some funds have been able to use hedging instruments that do not tie up as large amounts of capital as a trade in the relevant physical bond would.

The terms and issuance of shares are not as responsive to economic circumstances.

The risk to capital in the wholesale segment of the “reactive” OTC markets is exacerbated by the pressure on liquidity. This has led to the development of dynamic hedging asset classes in Europe (IRS, CDS). These have outstripped the more heterogeneous US market, where interest rate yields

are tightly referred to the cost of government borrowing, and where corporate bonds are all of the same currency, and exist within the same underlying legal and tax system. These hedging techniques are most actively traded by those that risk the most capital in the trading markets, namely the banks. Increasingly the dynamic funds community including hedge funds have used derivatives to hedge their exposures. Daily volumes in the government bond market are significantly smaller than the institutional market in bond futures to which they relate[3].

For exactly the same reason, the use of bonds in the European repo market is many times bigger than the outstanding volume of the European government bond markets as market participants use the underlying bonds to collateralise their borrowing/lending activity[4].

A similar pattern is emerging in the CDS market, which is increasingly used to hedge the diverse and fragmented European credit bond market; as with the interest rates example above CDS have already created greater transparency and liquidity in the physical bond market, by reducing the risks for participants.

2.3 Transparency and Electronic Trading

ICAP has always advocated greater transparency in the OTC market and has invested heavily in electronic trading (regulated as MTF's under MiFID) to encourage transparency and liquidity. ICAP owns and operates several MTFs, including the BrokerTec platform and EBS (one of the world's two largest spot FX platforms). BrokerTec allows banks and financial institutions to trade in government bonds, mortgage backed securities, supranationals and agencies (World Bank, KfW, etc) basis and repo. EBS provides execution in liquid FX currency pairs. Both systems allow participants to see each tradable bid and offer (buy or sell price) submitted by all other participants – i.e. the best of each and full depth of other orders below - as well as the last traded price.

In our experience this very high level of transparency only suits certain markets at certain times: in BrokerTec's markets, for instance, only the current bond of each relevant maturity of each issuer is consistently electronically traded (e.g. the most recently issued 2, 3, 5 and 10 year bonds of the US Treasury – the "on-the-run" securities). The "old" 2, 3, 5 and 10 year bonds ("off-the-run") can be traded electronically but are in fact more often traded via voice brokers. The same is true of less liquid currency pairs, which are not traded via the EBS platform (even though there is no operational reason why not). **Each example reflects the underlying principle that market participants are reluctant to commit tradable prices to high degrees of transparency in markets that are less liquid.**

This means that one cannot even say that all US Treasury bonds benefit from the same high degree of transparency within the wholesale space. As the most coherent and largest government bond market in the world virtually all the on-the-run business is conducted via two electronic platforms (BrokerTec and eSpeed) but far from all the off-the-run is traded electronically (the majority is traded by voice), despite significant efforts to draw liquidity to electronic execution by ICAP and its competitors. This situation is exacerbated amongst European government issuers (where there are differences in legal systems, currencies in some cases, borrowing schedules, costs of borrowing (coupon), targeted investors and credit worthiness), and of course amongst the many thousands of corporate issuers below them.

The other practical issue is that developments in the levels of trading transparency are dynamic and continuing. A recent example would be the success of CDS platforms such as CreditEx, which in the last 24 months have captured electronic execution in CDS and improved transparency accordingly. Ironically there is no commensurately transparent platform in as high a level of use for the underlying bonds to which CDS relate – CDS are in fact used to mitigate the risks inherent in dealing in the intrinsically illiquid corporate bond market.

ICAP has discovered that not all products lend themselves to high levels of transparency, and continues to provide client demand in bespoke trades and illiquid markets by offering a voice service.

---

[3] Relative volumes being euro 30 bn for government bonds, 150 bn for all Eurex government bond futures (this is an all-to-all market so the bank-to-bank portion will be smaller than that) and 130 bn for bank-to-bank swaps. In contrast the US market trades US 200bn of government bonds daily, with only 80 bn of swaps. See "http://www.icma-group.org/content/surveys/previous.html"

[4] Outstanding volume in the European Government Bond markets is approximately 2,000 Billion Euro, whereas the repo survey indicated outstanding of nearly three times as much 5.800 Billion Euro as of June 06 (see http://www.icma-group.org/content/surveys/repo.html)

A voice broker still enhances liquidity, by assisting clients' anonymous negotiation of trades, but with the application of very limited and subjective transparency (e.g. only offering an indicative price on behalf of a client to other clients that the broker already knows have an interest in dealing, rather than speculatively showing the price to a wider section of the market or exposing a firm price in a volatile market).

The above comments provide background to the more detailed responses offered in response to the Commission's Call for Evidence below.

3. Commission call for evidence

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

EU financial institutions trade enormous volumes in a wide diversity of products outside the exchange environment for which there are underlying economic reasons. End investor participation in the majority of these markets is very limited – usually to a type of bond of limited scope or geographical spread of entity that is invested in. Bond market participation is overwhelmingly institutional, and although there are several sub-sectors in Europe that are notable exceptions to this (Italian markets and Danish mortgage bonds), policy should take into account the impact of mandatory EU-wide rules on such a large part of Europe's markets.

Private investors will usually not sell bonds actively in order to make a profit and tend to be very 'buy-and-hold' orientated. With the implementation of IFRS, investments are immediately categorised as buy-and-hold or ready for sale. Given the very limited nature of a private investor market in Europe in terms of secondary market price formation we feel there is no reason to broaden MiFID to fixed income trading activities.

As in other discussions, overregulation of any of Europe's financing or hedging markets, at a time when all are in a state of dynamic development, could have very negative effects on the ability of all investors to mitigate risk, and may pre-empt and distort beneficial market trends.

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

We see little value in focussing on cash bonds and the subsets mentioned in the consultation *separately* from asset-backed securities issues. Although the composition of the issues might come from a different area, the issuance of bonds is a financing technique. The variations in the terms and conditions of bonds mean that they do not represent a single, coherent asset class but simply a financing technique.

Bonds are transferable by nature and can be shaped for a particular investor market or be limited in terms. Bonds also vary by coupon, maturity, currency, issuer credit quality, convertibility, underlying asset performance and yield.

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

Within European markets there is already a very large amount of price availability for bonds that trade with any frequency.

The most notable development in the wholesale and institutional fixed income markets in recent years has been the expansion of electronic trading. In government bond markets several competing bank-to-bank platforms give participants in that market segment full pre and post-trade price transparency.

ICAP estimates that 2/3 of the outright cash market in Europe is traded electronically, with 1/3 through several large voice brokers. The degree of real-time transparency within the wholesale segment is therefore very high in the "commoditised" on-the-run section of the government bond market. In line with our remarks under question 1. transparency is generally available and useful to wholesale participants. This data can be sold or distributed if it has intrinsic value to, and demand from, market participants. This is very different from mandated publication which may inadvertently dissuade

participants from taking risk, particularly in times of market volatility. In less liquid markets, such as the credit bond market, the immediate publication of a trade price may immediately move the market against one of the parties to that trade. This would have a reverse effect for market efficiency and investor protection sought for under the proposed widening of MiFID pre- and post-trade transparency requirements into non-equities. Similarly, it is difficult to see what benefit there would be to delayed price publication other than a “day price” for institutional investor portfolio valuation purposes, particularly as execution transparency is constantly improving through developments in services such as MarketAxess and TradeWeb.

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

ICAP does not see any benefit in actively investigating cash government bonds, cash high-yield corporate bonds or asset backet securities for the reasons set out under question 3.

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?

a. ICAP sees no problems in the real-time price transparency which the market has delivered in the wholesale instrument markets which form the focus of this review

b. Mandatory pre-trade transparency as well as immediate publication of a trade price may move the market against one of the parties to that trade.

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?

a. As stated under question 3 there is already a high degree of price transparency. Even in the bank-to-institutional market with the development of RFQ systems such as TradeWeb and Market Axess. There is a very large amount of information available in the interest rate arena but increasingly in the credit/eurobond area as well (MarkIT, Creditex and ICAP as e-trading systems and iTraxx and iBoxx CDS indices themselves). Adding additional burden on the industry to provide pre- and post-trading transparency is not going to help investor protection but will have the opposite effect for transaction liquidity purposes.

b. Mandatory pre-trade price transparency would endanger current tight spreads and thus endanger current liquidity. As to post-trade transparency collection for valuation purposes a composite daily actual trade price could be considered through industry coordination and some investment in systems. This needs to be preceded by agreements on how the data would be processed, controlled and distributed.

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?

Price transparency for a non-professional investor in what can be sophisticated products will achieve little to protect them from credit defaults, issuer fraud or the inability to sell a small amount of bonds in difficult market conditions. Investor protection would be better served by the proper implementation of

best execution requirements and suitability obligations on banks. Given the size of the non-professional investments any comparison with equity financial instruments would make the product offering from the banking community uneconomical and thus have a very negative impact on the end user (less income, or higher interest charges for the borrower). The degree of real-time transparency within the wholesale segment is very high, but only in relation to the comparatively "commoditised" government bond market. Transparency is generally only available and indeed useful to wholesale participants which trade very fast in very large size (minimum EUR1m face value, with average trade size in the region of EUR5m – EUR10m). If transparency to the non-professional investor would be forced for each single deal the pricing of such products, be it bonds or any kind of derivative would make it uneconomical for the seller who would be forced to charge a higher spread to the buy-side. Through this process the buy-side would be the ultimate looser because of transparency imposed by regulation.

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?

ICAP provides large amounts of data to clients, third party data vendors and owns GovPX, a provider of real-time pre and post trade data for US Treasury (UST) debt instruments. ICAP also intermediates in futures and OTC derivatives markets and provides the benchmark euro yield curve published on Reuters (and others) based on its interest rate swaps brokerage activity. The logic of publishing data for a fee is that the data has value to the wider market, hence the publication of our UST and euro swaps data (the two most viewed data pages on the Reuters network). In those specific cases the value is attributable to the fact that the data is the best indication of current interest rates in the relevant currency.

However, there is also data that is not valuable because it is too thin or not illustrative of any useful economic indicator, or data which is misleading or could has a distortative effect on the operation of the market. By way of example the BrokerTec MTF has a facility for trading CDS, and some single reference obligation swaps are traded so infrequently that although the system shows all participants the "last traded" price, it may be days or weeks old and therefore not a very relevant point of reference. By comparison, to mandate the publication of physical corporate bond trades immediately after execution could easily cause an immediate shift in market price against the buyer or seller (or indeed a shift in the value of the corresponding CDS used to hedge the trade or other similar trades).

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 European Repo Council, under the auspices of ICMA (International Capital Markets Association) collects data on repo transactions in a bi-annual report. This report compiled in an effort to gather data from some 80 major financial institutions in Europe and is available on www.icma-group.org
- Reference is made to a recent publication by the ECB called "Implications for Liquidity from Innovation and Transparency in the European Corporate Bond Market" by Marco Lagana, Martin Perina and Isabel von Koppen-Mertes and Avinash Persaud. Publication date August 2006. www.ecb.int/pub/pdf/scpops/ecbocp50.pdf

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

There is no real evidence of market failure at this stage. The flexibility and diversity of bonds allows issuers/borrowers to raise money as required and investors to shape their portfolios in a detailed way. The same diversity places great pressures on the consistent application of capital within the market. Although direct comparisons of price volatility are difficult it can be shown by way of example that in the case of the US, the S&P 500 listed shares have been substantially more volatile than US Treasury instruments over the period 1925 to 2000[5]. The effect is that there is a narrower risk/return deviation

[5] see "http://www.duke.edu/~charvey/Classes/ba350_1997/history/history.htm"

and indeed ratio for government bonds, despite the comparative similarity in risk return ratios between underlying interest rate volatility and share price volatility.

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

There is a fundamental difference between transparency in the equity market and other markets, in particular as to the benefit of consumer protection. Additional enforced pre- and post-trade transparency would in our view damage the retail investor as professional wholesale market makers would see limited benefit of providing a similar service as today unless a higher remuneration for the additional risk to be taken can be transmitted. As a direct consequence the aim of vitalising the efficiency of Europe's economy and the economic welfare of its citizens would be harmed by reducing choices for issuers and investors.

As already discussed, shares are substantially more volatile than other investments, and benefit from subjective comparison during price formation. Most retail investors do not have direct access to bonds, nor to other more complex hedging transactions, which in most cases can be explained by the fact that there are other more efficient means of achieving the same economic effect (such as opening a high interest bank account instead of buying a government bond to achieve an interest rate return). Those investors that do have access to bonds should be advised of the risks of that sort of asset – a bond will either keep paying the coupon (interest) and redeem the nominal (face) amount on maturity, or it won't (due to the insolvency of the issuer - it is as such an "all of nothing" asset; e.g. Parmalat). As already seen, bonds have a very short liquidity life so are correspondingly more difficult to sell over time. Shares have no "maturity" as such, are constantly tradable and inherently volatile – however they usually show a slow decline in the fortune of a company (absent instances of fraud, such as ENRON).

Investor protection is best served by the proper implementation of best execution requirements and suitability obligations on banks. Price transparency for a non-professional investor in what can be sophisticated products will achieve little to protect them from credit defaults, issuer fraud or the inability to sell a small amount of bonds in difficult market conditions.

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 TRACE10 experience in the US?

TRACE is a post-trade facility used for corporate bonds in the US. The markets in Europe are clearly of a different composition as the US market has one legal system, one common tax system and one currency. There is no coherence of government credit quality in Europe, there are differences in the legal custody and settlement systems and tax harmonisation is not being considered. The multiplication and fragmentation of access in the different asset classes in Europe have been the cause of the development of CDS as a means of developing some credit homogony.

Establishing a TRACE-like reporting system in Europe would increase the risk taking capital by the trading community and be a clear negative move with loss of market makers and liquidity in these instruments. There is also no clear benefit to introduce electronic trading facilities because of the lack of liquidity in these instruments. Electronic trading systems only work in efficient and highly liquid markets. Thinner market conditions will create more risks if post transparency is enforced. This can be illustrated by an example of the German bunds where the market moves all the time anyway i.e. clearly similar to the US bond market conditions. As such the market is fully transparent. The frequency of trading in corporate bonds is very sporadic. Introducing a TRACE-like regulation in Europe would actually decrease liquidity in the markets and be counterproductive.

Asset backed and mortgage backed securities price information is available in the US because of a requirement by the fund managers. In Europe this remains an issue but private initiatives by the industry guided by the European Securitisation Forum together with input from the European Repo Council are currently being implemented to enhance relevant levels of transparency for this particular asset class. The frequency of trading in these particular securities is low and re-pricing for most is limited to the monthly coupon payment. The trading life of most bonds is very short, with high activity at the phase of auction and distribution of the bonds, but becoming very limited after that.

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?

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?

ICAP does not believe any particular action for trade transparency warrants EU-level actions if the current consultation by DG Competition in trading, clearing and settlement and the work of the Cesame and the ECB (Target 2 cash & securities) in creating a European framework for clearing and settlement materialise as expected in the near future. In particular because these various initiatives together with private industry initiatives increased competition better and cheaper networks and systems will produce more transparency and liquidity in the short-to-medium term. DG COMP has already identified competition between trading platforms as one of the key aims for the efficient development of Europe's capital markets[6]. Any mandated rules on transparency in any of the very diverse OTC markets could easily inhibit competition and development.

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?

In respect of both pre- and post-trade transparency we would opt for a continuous self-regulatory framework by the financial industry and continued development of greater marker efficiencies). As mentioned in our response in question 13/14, we strongly believe that full competition in the market making activities and an open infrastructure in the clearing and settlement area will be able to deliver transparent markets for the end users.

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?**

ICAP believes that recent market developments have already served to enhance transparency, but that transparency itself is only relevant to the extent it enhances liquidity or the ability for investors to trade at the correct level and achieve the economic effects they require.

All dimensions of the OTC environment are more subtle and sophisticated than the listed exchange environment, and it is difficult to see how any general rules could be applied without distortion. By way of example we often execute trades for clients where one bond is exchanged for another (rather than two outright trades):

> On 15 August 2006 at approx 14:00 two of our clients agreed to a transaction in which one bought July 2015 maturity German Bunds (DBR 3.25% 07/15) against October 2015 French OATs (OAT 3.00% 10/15):
>
> At the time the cash market price for the Bund = 94.900, and the cash price for the OAT = 92.648
> Based on that cash price and the coupon interest rate the yield of Bund = 3.94, and the yield of OAT = 3.97
>
> Therefore buying Bunds as a switch loses the trader 2.9 basis points (0.029%) in comparison with the cash price.

[6] EC DG COMP (Services, Financial services (banking and insurance) "Competition in EU securities trading and post-trading Issues Paper" 24 May 2006.

> The downside in trading this apparently un-economic deal is outweighed by the advantages of simultaneous execution (the trader is sure of trading both sides) and a single trade with a single fee to pay to the broker.

In other examples we increasingly execute "asset swaps" where traders buy a government bond, and sell the interest rate performance of an interest rate swap. This allows the bank to fix its interest rate swap and pay no worse than the difference between actual interest rates and the fixed rate under the swap, again mitigating risk.

It is a feature of OTC markets that they evolve products to mitigate risk by developing novel execution and hedging techniques. Professional investors can take advantage of bespoke trades and structures that achieve a specific economic effect. It is this level of development that has allowed retail investors to benefit from fixed rate borrowing and mortgages.

ICAP does not believe there is any justification for mandated trade transparency, and that there is a risk posed to end investors by limiting the ability of banks to hedge themselves efficiently. Competition seems likely to be the best means to provide innovative execution and indeed new products – the principal distinction between exchange traded products and OTC trading is that the users define the scope of the trade in OTC, rather than having it dictated to them.

The mandatory publication of prices on a particular MTF is the only recent identifiable market failure as a consequence of the Citigroup trades on the MTS systems and Eurex in 2004 (where the objection of the banks that were adversely affected was that there posted tradable prices had been executed - underlying the obvious point that these banks would not have exposed their prices to the market without the mandatory requirement to do so). The current IT infrastructure across the professional markets allows the buy-side to collect price information on OTC derivatives and securities without necessarily impacting trading opportunities. Transparency by itself does not cure the pressure on liquidity, nor does it normalise volatility; open markets however do create transparency and liquidity by allowing competition to play at full.

In light of the above and given the transparency requirements of MiFID were negotiated with reference to shares, we see this not as a meaningful point from which to start any review of transparency requirements in non-exchange traded products. If the market can be made more efficient through additional enhancements one should exercise great caution when dealing with assets that are economically sensitive in several diverse dimensions. Distinction should also be made about the usefulness of the voice traded business that often helps liquidity and creates markets. A move into electronic execution only makes sense in more mature market with a minimum market depth and even then only in the most liquid section of such market.

ICAP Group
15 September 2006