

NON EQUITY MARKET TRANSPARENCY CESR: CONSULTATION PAPER FBF'S RESPONSE

GENERAL REMARKS

1. The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 500 commercial, cooperative and mutual banks. FBF member banks have more than 25,500 permanent branches in France. They employ 500,000 people in France and around the world, and service 48 million customers.

As universal banks, French credit institutions are directly and highly impacted by the enforcement of the MiFID on their main business lines: corporate and investment banking, intermediation, distribution.

2. In this context, the FBF has given its views on the opportunity of implementing a market transparency of financial markets other than equities. The FBF has sent a response to the call for evidence published by the European Commission last autumn in the context of the article 65 (1) of the Level 1 Directive and has given its position concerning the call for evidence published on February 2007 by CESR.

The FBF's position appeared to be shared by the vast majority of respondents. In sum, mandated pre-trade transparency in the non equity market is unnecessary. Post trade transparency rules may be possible but under certain conditions.

The FBF welcomes the opportunity to respond to CESR on non equities market transparency. Before tackling the matter of non equity market, the FBF would like to recall certain statements about the Equity markets contained in its former answer send to European Commission in September 2006:

- First, the liquidity and price discovery process depend largely on the centralisation of the transactions (except for block trades);
- Second, the transactions are largely centralised and the trading venues are mature;

- Third, there is a permanent flow of financial information concerning issuers (from both Medias and publication of periodic accounts) which largely defines the investors' behaviour on the sell side or on the buy side;
- Four, there is an important retail market (on Euronext markets, for example: almost 30% of transactions and 10% of the volumes traded).

The combination of these four factors justifies the high level of pre and post-trade transparency implemented by the MiFID on the Equity markets. This transparency is a tool to protect retail investors.

3. Characteristic of non-equity markets

The FBF strongly support CESR's statement in paragraph 10 of the consultation paper that price transparency rules applied to equity markets are not suitable to be transferred to bond markets. As a matter of fact, the bond markets structurally differ from the Equity so that such transparency is not natural. The prevention of the market failure on bond markets depend on the two following factors: the fair competition between dealers and the liquidity. The transparency is a consequence of the combination of these two factors, but is not a precondition.

The structural differences between Bond markets and Equity markets are the following:

- By nature, Bond markets are largely wholesale markets on which the intermediaries are remunerated by spreads and not by commissions, since they act on their own account.
- The integrity of the market and the prevention of the market failure depend on the competition between the dealers who bring liquidity and not on the transparency.
- In most cases, the very few retail investors in France keep the instrument until the maturity; the reason why there is no secondary market for retail investors reflects the fact that these investors are only looking for a stable and annual remuneration of their placement.

4. Market failure

The majority of respondent to CESR's previous call for evidence stated that there was no market failure affecting bond markets.

There is no evidence of market failure in the wholesale bond market. In the retail market, which is very limited in France and mostly a primary market, it appears that retail investors do not have easy access to the trade data available in the wholesale market at a reasonable cost. Such asymmetry in the information cannot be legislating away in so far as retail clients would not be able to replicate the systems by the wholesale firms.

Moreover, the balance of expected benefit to the retail investor, however, probably lies in the health of the wholesale markets. Unintended consequences by regulatory initiatives affecting the wholesale market might reduce the protection provided by efficient and transparent wholesale markets to retail investors.

5. Pre trade transparency & post trade transparency

Mandated pre-trade transparency is increasingly unnecessary in the European bond market and presents problems of implementation and probable unintended consequences that make it unlikely that benefits would outweigh costs. To be clear, such transparency would be detrimental to the liquidity and thus to the efficiency of the wholesale market and as a consequence of the retail market.

Mandated real time post-trade transparency in the European bond market would probably lead to a reduction in market maker liquidity, at least for less liquid and less highly rated issues. In addition, real-time post-trade transparency might be counter productive for maintaining the existing level of commercially driven pre-trade transparency in the European bond market (the offers made by the market makers).

Delayed post-trade-transparency is feasible, at certain conditions. The Commission should consult with the industry on how increased self-regulation could be achieved and maintain a watching brief on developments. In this context, the ICMA's proposal seems interesting and should be further analysed.

Indeed, it could be useful, as ICMA proposed, to implement a self-regulation on the basis of a post-trade transparency at the following conditions:

- The post trade transparency should apply on transactions no larger than 50 000 euros;
- The publication of the conditions of the transaction should be made after a delay of at least thirty minutes.

5. Investor protection

The organisation of the distribution of financial instruments and as a consequence of the protection of the retail investors is not based only on the transparency provisions. As regards to the retail investors, the protection is organised by the principles of suitability and appropriateness which are to be implemented. Since the retail bond markets are essentially primary markets, the FBF does not see as an evidence that the implementation of transparency would increase the protection of retail investors.

6. MIFID timeline

The FBF considers that now is not the opportune moment to consider a review of the scope of MiFID before this Directive has not been fully implemented across Europe. Vital experience can be gained from the implementation of MiFID to those classes of instrument as currently foreseen by the Directive and with the benefit of this experience a review of the nature set out under Article 65(1) could then be more appropriately tackled.

DETAILED REMARKS

Q1: To what extent do you agree with CESR's assessment of market failure in the secondary bond markets?

Regarding the market practices today, the FBF sees no evidence that there is a market failure in the wholesale bond market. Considering the retail bond market, which is not developed in France due to the lack of demand from retail investors, the retail investors have no appetite to invest directly in bond instruments and generally keep the instrument until the maturity.

Retail investor may receive less data or the data they obtain may be more delayed. However, the whole concept of having a specialised bond trading desk presumed to have real time information provider, own trading screens, a quite and efficient reactivity that cannot be replicate by retail investor.

Furthermore, considering the retail investors, the FBF would argue that asymmetries of information in respect of price formation in the cash bond markets represent a necessary characteristic of this particular market. Obtaining the right amount of information is part of the market process. At the same time, this information asymmetry is the main driver for market participants to supply liquidity to the market.

On the bond markets, the investor acts as a "shopping around consumer": there is a healthy competition between the market makers and the investor chooses the one with whom he will trade regarding the offers of all the market makers.

The FBF's strongly support CESR conclusion that an increase in transparency will need to be carefully tailored to ensure that liquidity provisions and level of competition were not be damaged.

Q2: To what extent do you agree with CESR's conclusions regarding the impact of imposing mandatory pre- or post-trade transparency requirements?

CESR highlights that bond and equity markets clearly differ and increasing transparency in bond markets may not have the same effect on price formation and liquidity as in equity markets. It is important to bear in mind that the bond markets structurally differ from the equity so that such transparency is not natural. The prevention of market failure on bond markets depend on the following factors: the fair competition between dealers and the liquidity. The transparency is the consequence of the combination of these two factors, but not a precondition.

That's why, the FBF strongly support CESR's conclusion that transparency should only be increased if the associated benefit would outweigh the costs to market participants, including the loss of significant levels of liquidity.

Q3: To what extent do you think retail investor protection considerations would justify mandating pre- or post trade transparency?

From FBF's point of view, mandatory solutions should be avoided. Retail investor protection considerations should not justify mandating pre or post trade transparency. To be clear, the FBF does not think that the pre and/or post trade transparency is the suitable solution to ensure retail investor protection in the MIFID context.

As a matter of fact, the market efficiency and the competitiveness of the European market should justify themselves none additional transparency. Particularly since, the MIFID is likely to improve retail investor protection and information in the bond markets via the conduct of business rules (suitability and appropriateness test).

Q4: To what extent do you think that the introduction of the new best execution requirements will result in a change in the level of transparency information provided on a voluntary basis by the industry?

It is important to bear in mind that transparency on the bond market is due to fair competition between dealers and the liquidity. It's a combination of these two factors and not a precondition.

The differences between bond markets and equity markets have consequences not only on the transparency approach but also on the best execution requirement.

On the bond markets, the investor acts as a "shopping around consumer". There is a healthy competition between the market makers and the investor who chooses the one with whom he will trade regarding the offers of all the market makers.

Q5: How would you propose retail investor education be improved and delivered?

Information is essential to clients understanding. That's why all actors have to be involved in the deliverance of the information. Information should be delivered by the firms, the regulatory and also via associations.

It is important to note that all actors have interests in improving and delivering retail investor education.

The implementation of new obligations such as suitability, appropriateness and best execution will naturally improved little by little investor information and education.

Investor education is of paramount importance and the French regulator with the industry, associations and university are really involved in the investor education via the creation of an independent association named "institute for financial education of the public".

Q6: To what extent do you agree with the suggestion that the defaults that have affected retail investors in recent years have been the result of factors other than transparency? If you feel that transparency levels were of significance in these losses, please explain how.

The FBF supports CESR's conclusion that losses for retail investors were not the result of, nor could have been prevented by, greater market transparency. Those experiences, dominated by corporate fraud, support the FBF's position relating to non additional transparency rules.

Q7: To what extent do you agree with CESR's assessment that any transparency requirements could viability be segmented?

The FBF's is maintained is position relating to pre transparency requirement. The pre trade transparency would be very difficult to implement, and could be detrimental to the competition between the market makers and thus to the liquidity of the markets.

The FBF does not have the certainty that transparency requirement could viability be segmented. On this point, the FBF would like to mention the EFB:

We appreciate CESR noting that the "careful design" of any segmented transparency requirements would have to be aligned with the "nature and scale of any perceived market failures." That said the doubts about the viability of harmonizing pre- and post trade transparency requirements *per se* remain due to market specificities and the potential disturbance to the smooth operation of non-equity markets such intervention could produce. Clearly, pre- and post-trade transparency must be de-coupled from the outset given the price formation process in non-equity markets, which in itself varies according to instrument and the way in which it is traded. By advocating a segmented approach, CESR recognizes the distinct nature on non-equity asset classes and that a solution for one asset class cannot be readily read across to other asset classes with different characteristics.

However, CESR should be cautious insofar as there are unintended consequences of what it sets out, particularly in paragraph 61. Intermediaries will gravitate to the easiest way to become MiFID compliant. If this is based on an arbitrary categorization of non-equity products then price distortions would result around the limits of those categories. This is based on the experience with categorizing equities under MiFID. The definition of 'liquid' shares under MiFID has led to a set of equities across Europe that have extremely wide range of basic characteristics being considered 'liquid'. These liquid shares do not map to what the market would generally consider liquid."

Nevertheless, a post-trade transparency could be possible at certain conditions. Indeed, it could be useful, as ICMA proposed, to implement a self-regulation on the basis of a post-trade transparency at the following conditions:

- The post trade transparency should apply on transactions no larger than 50 000 euros;
- The publication of the conditions of the transaction should be made after a delay of at least thirty minutes.

The fixation of this threshold allows making a distinction between the retail transactions and the wholesale market on which the transparency would be detrimental to the liquidity.

8: Do you agree that we have captured the most important criteria that the Commission should take into account in judging possible self-regulatory initiatives? If you think there are other factors that should be noted, please provide details.

The FBF's broadly agrees with CESR's conclusion and the fact the issue is more one of who is best placed to deliver.

The industry has proved its strength of will and its ability to develop process for delivering transparency and others information to market users. Indeed, the industry its best placed to deliver self regulatory solution. However, such a process should depend on the cost benefit analysis result.