

4 June 2010

Comments from NYSE Euronext in response to CESR's technical advice to the European Commission in the context of MIFID Review: Non-equity markets transparency (CESR/10-510)

NYSE Euronext is a leading global operator of financial markets and a provider of innovative trading technologies. NYSE Euronext's exchanges in Europe (Amsterdam, Brussels, Lisbon, London and Paris) and the United States provide for the trading of cash equities, bonds, futures, options, and other exchange-traded products.

NYSE Euronext welcomes CESR's consultation paper on the "non-equity markets transparency". We are grateful for having the opportunity to provide comments on Bonds and Derivatives products.

Part 1 - Bonds

Remark: In the answers provided in this document, the definition of Corporate Bonds is too restrictive; we refer in this document to all fixed income products excluding complex and structured products.

- Q. 1. On the basis of your experience, could you please describe the sources of pre- and post-trade information that you use in your regular activity for each of the instruments within the scope of this consultation paper:**
- a) corporate bonds**
 - b) structured finance products (ABS and CDOs),**
 - c) CDS,**
 - d) interest rate derivatives,**
 - e) equity derivatives,**
 - f) foreign exchange derivatives,**
 - e) commodity derivatives?**

As a Regulated Market we are providing pre and post trade transparency.

For all fixed income products, the main feature of the regulated market is that it is built around an open order book, displaying size and price. In our opinion, the only way to guarantee and provide market depth is through firm prices and orders.

The current OTC market is not centralized and market information is widely disseminated throughout an array of e-platforms, it is also to be noted that a large portion of OTC trading still occurs via voice negotiation. It is almost impossible for investors to investigate prices across all dealers prior to a trade.

Concerning post trade transparency, there is a lack of reliable data identifying realized transactions, there is also a lack of reporting of this data however unreliable it may be. This approximate data has an impact on asset valuation. We suggest the creation of a "reference price" based on market prices. This reference price will also be useful for issuers who are considering tapping the market.



Q.2 Are there other particular instruments that should be considered as ‘corporate bonds’ for the purpose of future transparency requirements under MiFID?

Transparency is also needed for all different types of Bond issuers, whether it is for real Corporate Bonds or Financial Companies, Covered Bonds, ABS, Agencies and Sovereign Bonds. Recent events in relation to the Greek Debt have highlighted the limits of the OTC market. In similar circumstances, quotes are given as indicative rather than firm and market depth information lacks real interests. Voice transacting and/or electronic trading outside RMs and MTFs do not carry established rules nor enforce common dealing practices across market practitioners. The current non-standardisation of the trading environment and the lack of common governance create market situations that can be described as market failures.

Q.3 In your view, would it be more appropriate, in certain circumstances, to consider certain covered bonds as structured finance products rather than corporate bonds for transparency purposes? Please explain your rationale.

All Covered Bonds, such as French “*Obligations Foncières*”, Spanish “*Cedulas*”, German “*Pfandbriefe*” issued under specific EU should be considered as Bonds.

Q. 4 On the basis of your experience, have you perceived a lack of pre-trade transparency either in terms of having access to pre-trade information on corporate bonds or in terms of the content of pre-trade transparency information available?

Q. 13 On the basis of your experience, have you perceived a lack of pre-trade transparency in terms of access to and the content of pre-trade information available in the market for ABS?

Fragmentation due to disseminated liquidity on various platforms does not allow investors to have a full view of available liquidity, unless they develop specific sophisticated tools to gather price and size information from these platforms. In any case, such functionality doesn’t cover all liquidity as liquidity is almost impossible to monitor for voice dealing investor liquidity. We believe that a platform centralizing all firm orders and interests from these various sources should be developed, be RMs, MTFs, private electronic platforms and brokerage platforms.

Q. 5 In your view, do all potential market participants have access to pre-trade transparency information on corporate bonds on equal grounds (for example, retail investors)? Please provide supporting evidence.

Q. 14 Is pre-trade transparency information readily available to all potential market participants?

No. It is well known that retail investors do not have access to the same level of information in the Bond market as institutional investors. Some issuers raise Debt with €50k nominal Bonds to target institutional investors only. On the other hand, some issuers strictly target retail investors and these two classes of assets are not fungible. The consequences of such targeted placement methods create a split in pricing that is very visible in the secondary market. Different prices and bid-ask spreads are offered to different types of investors. For example, a most usual market practice from the sell-side is appropriately known as ‘customer tiering’; the goal of this practice is to quote different spreads according to the importance of the



sell-side relationship with their end clients. Some banks have up to 4 tiers, they justify through the need for managing counterparty risk when, in fact, it could be a commercial strategy.

Q. 6 Is pre-trade transparency efficiently disseminated to market participants? Should pre-trade information be available on a consolidated basis?

Q. 15 Is pre-trade information currently available in the ABS market consolidated and effectively disseminated to those market participants who make use of it?

No it is not available. Request for Quote (RFQ) models do not disseminate firm interests; this coupled with indicative streaming of prices contribute to the construction of a composite price which itself then becomes indicative. The split between the BtoB on one side and the BtoC on the other side also contributes to more fragmentation. We believe that the market model should be 'all to all' and driven by firm orders, such a model would lead to all interests being disseminated equally to all investors.

Q. 7 What are potential benefits and drawbacks of a pre-trade transparency regime for:
a) the wholesale market; and
b) the retail market?

If you consider that there are drawbacks, please provide suggestions on how these might be mitigated.

Q. 16 Which potential benefits and drawbacks of a pre-trade transparency regime do you see for the ABS market? If you see drawbacks, please explain how these might be mitigated.

Concerning the benefits to the wholesale market, please refer to previous answers.

Concerning the access to firm interests rather than indicative pricing, we see drawbacks for the wholesale market. Wholesalers favor a price formation mechanism in which there is little real time transparency. Large size transactions would still need to be matched on a separate segment so as to avoid market manipulation and price impact. For the same reason, some time delays in publication should be considered.

Concerning the retail market, we see no real drawbacks to pre-trade transparency. Retail investors should be offered the same access to market information as institutional investors; as such we believe that regulated markets are the best solution for retail investors.

Q. 8 What key components should a pre-trade transparency framework for corporate bonds have? What pre-trade information should be disclosed?

Q. 17 Which key components should a pre-trade transparency framework for ABS have? Which pre-trade information should be disclosed?

There should be full availability of the order book (prices and volumes) in real time. Reservation thresholds with notification to investors in case of market suspension are a pre-requisite to the efficient running of a Bond platform

Concerning the segmentation for large trades please refer to our answer to Question 7.



Q. 9 Do you think that notional value would be a meaningful piece of information to be made accessible to market participants? Is there any other information that would be relevant to the market?

We believe that the dissemination of a reference price (please refer to Question 1) calculated with a calibration based on the weighted average of the daily turnover would offer great value to the market.

We believe that trade publication should be slightly delayed (e.g. 15 minutes) for large trades (to be defined according to the percentage of the outstanding).

Q.10 Do you agree with the initial proposal for the calibration of post-trade transparency for corporate bonds? If not, please provide a rationale and an alternative proposal (including supporting analysis).

See answer to Q9 (weighted average).

Q.11 Should other criteria be considered for establishing appropriate post-trade transparency thresholds?

See answer to Q9 (weighted average).

Q.12 Given the current structure of the corporate bond market and existing systems, what would be a sensible benchmark for interpreting “as close to real time as possible”?

The delay for publication for corporate bonds should be defined according to the size of the issue (% of total amount issued). We believe that trade publication should be slightly delayed (e.g. 15 minutes) for large trades (to be defined according to the percentage of the outstanding).

For all other bonds, the reporting should be in real time.

PART II - DERIVATIVES (Interest rate derivatives, Equity derivatives, Commodity derivatives and FOREX derivatives)

In NYSE Euronext’s opinion the wide and diverse range of products, customers and needs that constitute the derivatives markets make it difficult to answer in a direct manner the questions posed by CESR. Therefore, at this stage in the policy formation process, NYSE Euronext proposes instead that CESR should consider using the following policy framework as a means of helping it to formulate the appropriate pre- and post-trade transparency arrangements for each type of derivatives product.

1 Background

- 1.1 Currently, MIFID pre-trade and post-trade transparency rules apply solely to cash equities trading, whether such trading is undertaken on-exchange, through a Multilateral Trading Facility (“MTF”) or OTC through a firm which is a systematic internaliser.



- 1.2 Before considering the case for changes to the treatment of derivatives, it is important to bear in mind the fundamental distinctions between cash equities and derivatives (whatever the underlying) and the differences in relation to the competitive environment which they have traditionally inhabited.
- 1.3 Taking the fundamental differences first, they fall into three basic categories:
- (a) Transferability – i.e. cash equities are transferable securities, which means that exactly the same instrument is capable of being traded in different venues. Derivatives, in contrast, are not transferable securities but contractual arrangements imposing rights and obligations on the counterparties to such contracts. Derivatives are designed to meet specific economics/risk management needs, but as products competing to meet the same economic needs can differ in various aspects of design (e.g. choice of governing law, cash settlement or physical delivery etc) such competing products are not fungible even though they may be priced off the same underlying instruments.
 - (b) The importance of positions and clearing – these factors are essential to derivatives, given that to be of economic utility, contracts are designed with maturities of many months or years, whereas cash equities settle within days and until recent years many markets did so without involving a CCP (given their more limited “maturity profile”).
 - (c) Complexity – cash equities are straightforward products, whereas derivatives can be extremely multidimensional and, in certain cases, are highly bespoke. Moreover, some derivatives markets – such as financial options – are characterised by a large proportion of strategy trades which involved a highly tailored risk/reward profile (i.e. a single trade will comprise trading a combination of different exercise prices, maturities and calls and puts in respect of a particular instrument) - as opposed to trading on a so-called “outright” basis (i.e. trading in a single exercise price, expiry month and put or call).
- 1.4 Turning to the competitive environment, pre-MIFID many European cash equities markets operated on the basis of the concentration principle, which sought to bring all orders and activity into a single venue. Indeed, one of the main objectives of MIFID was to remove the concentration principle and open up the cash equities markets to greater competition through competing exchanges, MTFs and systematic internalisers. In contrast, the derivatives markets – both pre- and post-MIFID - have always been characterised by a high degree of competition, both between exchanges competing for similar products or for liquidity providers and between exchanges and the OTC market. Such competition has not been prevented by the fact that derivatives products are generally not fungible or by the fact that MIFID does not impose a transparency regime applicable to all competing venues; on the contrary previous experience clearly demonstrates that over a period all the liquidity can move from one venue to another.
- 1.5 Bearing in mind the different starting point for derivatives compared with cash equities, as explained above, NYSE Euronext would advocate that the determination of transparency arrangements for derivatives should be based on the following guiding principles:
- (a) It should not be assumed that the solution which has been adopted for cash equities would be suitable for derivatives.
 - (b) It would be necessary to examine whether any inefficiencies exist in the market concerned and whether transparency changes would address them. It should not be assumed that transparency changes are the solution to any or all identified inefficiencies.
 - (c) Any transparency changes should be designed to avoid damaging current market liquidity, price formation and best execution.

2 Proposed Price Transparency Framework



- 2.1 As is the case in the cash equities environment, it is assumed that derivatives trading within Europe post-review will be capable of being undertaken either on-exchange, through an MTF or by systematic internalisers in the OTC market. We consider it is essential that where economically similar “lookalike” (albeit not fungible) derivatives are available in these different fora, they will be subject to equivalent transparency arrangements in order to optimize the price formation and discovery process and to limit the scope for regulatory arbitrage (in relation to the latter, we believe that equivalent regulatory requirements in general should apply to all trading venues). Finally, it is assumed that loopholes will be closed which currently allow crossing networks in the cash equity markets to avoid MIFID transparency requirements. In other words, if it is concluded that no transparency requirements are to apply to a particular derivatives product, it will be because an objective analysis of the market in the product in question has led to a determination that this is the appropriate policy response for that particular market.
- 2.2 Within that overall context, it would then be necessary to apply a series of tests in order to calibrate the appropriate price transparency arrangements for the derivatives product in question. NYSE Euronext suggests that the tests should be as follows:

Pre-trade Price Transparency

- (a) Is pre-trade price transparency required by the users of the product in question (or a significant subset of users) in order for them to price or value it properly?
- (b) Is pre-trade price transparency required for the process of matching buyers and sellers (i.e. “counterparty discovery”) to operate in an efficient manner?
- (c) Is the product traded on a reasonably regular basis by market participants generally or is it traded on an extremely infrequent or “one off” basis?
- (d) Can the key characteristics of bids and offers in the product be recorded and published in a readily understandable and digestible manner which avoids misleading users? In other words, taking (c) and (d) together, is the product sufficiently standardised?
- (e) Can pre-trade price transparency be achieved without impairing market liquidity e.g. in a manner which is positive or neutral in terms of the willingness of market participants to make competitive prices in reasonable size?
- (f) If the answer to questions (a) to (e) are “yes” (or a qualified “yes”), are there some forms of business in the product which would be fostered by limitations to pre-trade transparency in specified circumstances, e.g. for block-sized business?

Post-trade Price Transparency

- (g) Is post-trade price transparency required by the users of the product in question (or a significant subset of users) in order for them to price or value it properly or to assess whether “best execution” has been achieved?
- (h) Is the product traded on a reasonably regular basis by market participants generally or is it traded on an extremely infrequent or “one off” basis?
- (i) Can the key characteristics of transactions in the product be recorded and published in a readily understandable and digestible manner which avoids misleading users?
- (j) Can post trade price transparency be achieved without impairing market liquidity e.g. in a manner which is positive or neutral in terms of the willingness of market participants to make competitive prices in reasonable size?



- (k) If the answer to questions (g) to (j) are “yes” (or a qualified “yes”), are there some forms of business in the product which would be fostered by limitations to post-trade transparency in specified circumstances?

2.3 Each product would need to be assessed against the tests set out under paragraph 3.2. This would result in an analysis of the appropriate price transparency arrangements for the product concerned. Depending on the product in question, it might for example be appropriate to apply only post-trade transparency but not pre-trade transparency. We would envisage the assessment process involving all relevant stake holders, i.e. the relevant regulatory authorities, trading venue operators and market participants.

3 Next Steps

NYSE Euronext is grateful for the opportunity to provide comments to CESR in relation to non-equity markets transparency. NYSE Euronext would be happy to discuss its comments further with CESR and national regulators.