QUESTIONS FOR RETAIL INVESTORS ON THE CONSULTATION PAPER ON "NON EQUITY MARKETS TRANSPARENCY"

FIN-USE RESPONSES
19/02/2009

Preliminary remarks

FIN-USE is the European Expert Forum of Financial Services Users. It represents individual investors point of view who are obviously impacted by the "non equity markets transparency" issues.

For FIN-USE, this CESR consultation on "non equity markets transparency" bears five serious weaknesses:

1/ This CESR consultation and all its questions are addressed to "*market participants*". At the same time, individual investors are invited to reply to this consultation. The problem is that individual investors are most often unfortunately de facto not "market participants" in bond markets (except in Italy and partially in Spain). They have been de facto largely excluded from accessing these markets for decades. We believe this is indeed one of the reasons of the lack of transparency, the lack of liquidity and the recent failures of these markets. By contrast, the equities markets which are much more transparent and much more open to individual investors have always remained opened and liquid during the crisis. This explains why FIN-USE only expresses an opinion on the questions of this consultation that are relevant from the individual investors side.

2/ More generally, this consultation is tailored to market professionals and institutional investors, not to individual investors. The very short deadline (this consultation was presented to FIN-USE on January 28 for a reply by February 19) ignores the very limited resources of individual investors' representatives, especially compared to market professionals who have full teams paid and dedicated to do that. Also, the language used is only English and sometimes much too technical for individual investors. FIN-USE feels CESR puts individual investors at a clear disadvantage by not allowing for their unequal situation compared to professionals.

Given the very short deadline, we will reply only to the nine questions CESR identified as "*particularly relevant to representatives of Retail Investor Associations*".

3/ This consultation is supposedly addressing "*non equity markets transparency*". But in reality it addresses only the corporate fixed income markets, leaving aside the whole Government and public agencies bond markets, which represent the large majority of cash bond markets. Unfortunately, CESR does not explain such a large exclusion. Would CESR believe there are no transparency issues for Government bonds? This is not the view of FIN-USE. Individual investors have de facto no direct access to this major fixed income market as well. This situation derives at least partly from the lack of pre- and post-trade transparency in these markets.

This lack of direct access to fixed income markets for individual investors is a major issue. Individual investors do have direct access to equity markets and play a significant role there, not merely by the relative share of this market, but more importantly by ensuring day-to-day pre- and post-trade transparency at the investor / user / retail level. We believe this is one reason the European equity markets remained open and liquid during the 2008 financial crisis contrary to the fixed income markets. This is a big paradox: why facilitating individuals access to the most long term and risky financial asset class, and not to the shorter term and less risky ones? We would very much like CESR to focus on this fact.

4/ CESR has also further narrowed the scope of this consultation on "non equity markets transparency" to post-trade transparency only. Again, is CESR implicitly assuming that there are no issues with pre-trade transparency? FIN-USE believes there are also serious pre-trade transparency issues at the retail level. For example, we have failed to see any retail access to bid and ask orders books even for major bond issues. Many equity retail brokers provide such information online and real time for equities. Also, the CESR consultation paper seems to focus only on the secondary market. The primary corporate bond market has virtually shut down through part of 2008: this is a very serious issue that needs to be analyzed as well.

These implicit conclusions from CESR seem based on previous work by the "Financial Stability Forum". We do not know if retail investors are involved in this institution and FIN-USE was not contacted by it. Similarly, CESR mentions a session with industry experts and "*a representative from the retail side*", who was a FIN-USE representative who asked for more pre and post transparency measures on bond markets. One retail investor is very few compared to all the representatives from the financial industry. We wish to stress here again that retail investors are the major victims of the worst financial crisis since 1929, and they should be much more involved by regulators in the working process to fix it.

5/ This consultation does not include any analysis or questions on the impact of the major fixed income markets failure in 2008 on equity markets. FIN-USE believes many institutions which needed cash in 2008 (for example hedge funds) could not unload their fixed income securities because of the failure of these markets, and therefore unloaded part or all of their equity portfolios as the equity markets remained the only ones open and liquid. This would have of course played a significant role in the collapse of equity prices last year. It seems the regulated equities markets are a victim of their exemplarity. FIN-USE believes this is an important issue that should be thoroughly investigated by the financial regulators. The objectives of CESR on bonds markets transparency do not address the problem properly. It is only focussing on industry sustainability. Bonds markets need a new structure. The question would then be whether the fixed income markets should be regulated as the main equity ones.

"Questions particularly relevant to representatives of Retail Investor Associations:"

1. To what extent can corporate bond markets be characterized as wholesale or retail markets? How would you distinguish between wholesale and retail markets? What are the differences across the EU? (Question 22 of the consultation paper)

Obviously the bond markets are de facto wholesale, not retail (except in Italy and partially in Spain). A retail market is a market where individual investors play a significant role, even if it is much smaller than other participants'. Contrary to regulated equity markets in the EU, it is extremely difficult for individual investors to buy and sell bonds. We have many examples of even sophisticated and financially educated individual investors who do not know how to buy bonds. There are cases of redistributions of bonds issues between retail investors that must be addressed.

2. What would be the potential benefits and downsides of a harmonised pan-European transparency regime for the retail market? Would greater post-trade

transparency for example attract retail investors more? (Question 23 of the consultation paper)

Currently (except in Italy) there is no pre or post-trade transparency for retail investors. See Annex 1 for an example of the practical impossibility for a French individual investor to get basic trading information on a given bond issue. This annex also shows an alternative choice recently provided by insurers to individual investors to indirectly access the corporate bond market. But this indirect access is for the happy fews ("good" clients who will invest a minimum of € 10 000) and is not submitted to any of MiFID rules; especially in terms of best execution, information, advice and inducements. Pricing is also an issue.

This example shows that there is demand for bonds, and obviously individual investors would come to this market if it provided the same transparency as the equities markets, which are trading much more risky assets, and where they are active participants.

Another benefit of direct access to the bond markets (this includes the biggest one – the government and public agencies market as pointed out in our preliminary remarks) would be a potential for better performance than indirect access. Currently this indirect access is provided mainly by bond investment funds. Their performances have been on average very much below the ones of their relevant markets. For example, Bond funds in French corporate savings plans have returned 3,3% per year on average over eight years (1999-2006) versus 4,6% for the bond market[1]. And the situation is getting worst for bond funds investors as access to quality funds becomes more difficult and more costly (see annex 2: recent release from a major bond fund manager).

Also, CESR did not address in his consultation paper the indirect but severe damage to retail investors of the fixed income markets failures, especially in the money market funds area, when asset-backed securities markets actually shut down, eliminating any liquidity and fair pricing of many of these funds underlying assets. Even to-day, the valuation of bond funds and of bond portfolios indirectly held by retail investors (life insurance funds for example) is questionable. We also mentioned in our preliminary remarks the indirect damage done to the equities markets prices by the fixed income markets failure.

This means individual investors are penalized by the inaccessibility of bond markets, mainly due to their lack of transparency.

There are also cases of redistributions of bonds issues between retail investors that have produced severe damages to them (Lehman bonds, Iceland Banks Preferred Notes). In many cases, they have not received proper information on market value of their investments.

3. Do you believe that better post-trade transparency could improve the efficiency of the price discovery process, reducing bid-ask spreads and search costs for investors and fostering competition among dealers? (Question 13 of the consultation paper)

Obviously yes, as, again, it is actually non existent currently for individual investors in most Member States. The consultation paper does not actually analyze or give any data on the widening of bid-offer spreads. This is unfortunate and may be coming from a difficulty in getting the quantitative data for CESR itself. Quantitative measures would probably show huge bid-offer spreads. Also, this relates to a well-known behavior in the bond dealers world: fronting. Bond dealers will often "front" a trade with an investor to make a large profit later on selling it to another. The introduction of pre and post trade transparency at the retail level (as it exists in the equities markets) would most certainly reduce dealers' margins. This most

[1] Source : AFG, Europerformance, 2007 ; the bond market performance is measured by the Lehman Euro Aggregate Government Bond Index.

probably is one reason they fight it and argue that it would reduce liquidity. This is very unlikely. First because the current liquidity of bond markets is still appallingly low (see annex 2). Second because the much more transparent equities markets are also much more liquid.

The move by the Italian public authorities to apply all MiFID provisions to the Italian bond market is positive and a generalization to all member states should be carefully considered by CESR (see annex 3 on the situation in Italy).

4. Would additional post-trade transparency help investment firms to comply with MiFID requirements intended to enhance investor protection, such as information disclosure to clients, suitability assessments and providing best execution to investors? (Question 13 of the consultation paper)

Yes, definitely. Right now it is very difficult to assess best execution at the retail level. Also, as previously mentioned, best execution and other MiFID requirements do not apply to bond issues sold to individual investors packaged as units in insurance contracts (see annex 1). We are surprised that CESR does not mention also the MifID inducements, which aim at protecting retail investors against conflicts of interests at the distribution level.

5. Do you think that greater post-trade transparency could have a negative impact on liquidity? Or do you think that it could have any other drawbacks which CESR needs to consider? (Questions 13 and 14 of the consultation paper).

None, see our replies to Q3 and 4. We believe on the contrary that pre and post trade transparency at the retail level would improve liquidity, which, again, is almost non-existent nowadays (see annex 2). Again, the example of the equities markets clearly shows that more transparency and regulation only thoroughly increase liquidity.

6. Please provide information on your experience, if any, in terms of timing, content and access to information of the market-led solutions such as those of ICMA or SIFMA. What is your assessment of the effectiveness of the present self-regulatory initiatives? (Question 18 of the consultation paper)

As one can see through the example detailed in annex 1, there seems to be no effectiveness of ICMA and SIFMA "solutions" at the retail level. Again transparency at that level seems actually non existent (except in Italy). Self-regulations are facing their limits here, as elsewhere in the financial industry.

7. What would be the most cost-effective way of delivering additional transparency for the retail market: an industry-led solution, possibly based on a road map set by regulators, or mandatory regulatory post-trade transparency requirements? (Question 26 of the consultation paper)

Self –regulation has again shown its limits, not to say its failure in this area. As the Italian Government already concluded, mandatory regulation is needed quickly and again not only on post trade transparency, but also on pre-trade transparency.

8. Do you think that the introduction of additional post-trade information on prices could help restore market confidence and maintain market liquidity in times of future crisis? (Question 20 of the consultation paper)

It is going to take time to restore a badly damaged confidence and liquidity, but pre and post trade transparency at the retail level is certainly a badly needed pre-requisite. Everyone needs to see better what is happening on the fixed income markets. The only way is to provide an equivalent level of retail transparency as for the equities markets. Again, EC equities markets remained opened and liquid through even the toughest times of the 2008 financial crisis, contrary to the fixed income markets. On clear reason is the transparency of these markets operations, and their retail investor-friendly features, which are missing for fixed income.

9. Regarding structured finance products and credit derivatives, what post-trade information should be published? In addition to information about the price at which the transaction was executed, the volume and the time of the transaction, would there be any benefit in publishing information about portfolio composition, asset class, the initial interest (seller or buyer)? Is there any other information which would be relevant? When should post-trade information be published? Should it be published immediately after a trade has been concluded? (Questions 35 , 36, 44 and 45 of the consultation paper)

These markets are not accessible to individual investors, but they are indirectly exposed as fixed income funds and money market funds (at least up to 2007) were heavily invested in these products, especially asset-backed securities. Markets for asset-backed securities virtually shut down through part of 2007 and 2008. This created very serious liquidity issues for investment funds as well as valuation issues. These are markets that are too complex for retail investors (one could question if they are not too complex for the financial professionals as well when one sees how they handled them for the last two years) and should remain in the hands of professional participants, but at their own risk and responsibility, not to unload them to individual investors through investment funds (UCITS) or other retail collective instruments.

Individual investors who are affluent and/or financially educated should be able to buy bonds on the market, as easily as they can buy equities. The others should be able to participate in retail collective bond instruments really invested in bonds, excluding complex and inaccessible products: back to simplicity. The crisis has proven that the financial industry, the rating agencies and the auditors have not been able to master these asset-backed securities and credit derivatives themselves. Why unload them to individuals?

ANNEX 1

Retail corporate bond market transparency example

(Vodafone Group 6,875 % 12/2008)

December 2008, a French retail investor gets an offer to invest in this corporate bond from his online insurance broker, with a net yield of 6,035% (because of yearly fees of 0,80%).
He has to invest a minimum of € 10,000 in a unit of his unit-linked insurance contract.
He is provided with a link to the bond issue 76 page prospectus.

On February 7, 2009, he tried to check the market price of his investment.
On Boursorama.com, the biggest financial web portal in France, he cannot find the bond issue using the ISIN code (XS0402707367, provided by the online broker) or the issuer's name.
After going to Google, he discovers there is another code (A0T4DX) that works better to look for trading data.

The prospectus mentions that the issuer will ask for trading on the London Stock Exchange.
The fact sheet from the insurer mentions instead a listing in Luxembourg.
But the investor eventually finds quotes only coming from Frankfurt, Germany.

- Last quote on Boursorama is for February 6:

- Opening: 106,10
- High: 106,10
- Low: 106,10
- Volume: 0

- Only quote on BondMarketPrices.com (Xtracker, supposing this retail investor knows this site, which is very unlikely) is for February 6:

- Median: 107,41
- High: 107,69
- Low: 106,12
- Volume: data for the month of December 2008 only
- Average bid offer closing quotes: 106,94 / 107,85

It is not possible to get previous days' data.

- Only quote on the online broker's site:

January 30, 2009: 1059,76 €
(for January 30, Boursorama quote is 105,34, not available on Xtracker).

Conclusions:

- it is very difficult for a retail investor to find bond trading data.
- These trading data are sketchy and seriously inconsistent from one source to another: the low price from one source is higher than the high price on the other ! Therefore the trading data integrity is highly questionable.
- Only one source for daily trading volume, but highly doubtful as it is 0 every trading day.
- No information on the yield anywhere
- Only one source provided a bid/offer spread data, but only for one day and only at closing.

Therefore, it is impossible for this retail investor to have any idea of the price he could sell at.

ANNEX 2

Six Vanguard offshore funds temporarily closed to new investors

Vanguard has announced the temporary closure of six offshore bond index funds to all new investors effective on 2 February 2009. The funds are:

U.S Investment Grade Credit Index Fund
Euro Investment Grade Bond Index Fund
U.K. Investment Grade Bond Index Fund
Eurozone Inflation-Linked Bond Index Fund
30-40 Year Duration Euro Index Fund
Global Bond Index Fund

Vanguard has taken this proactive step in order to protect shareholders in the funds. The persistence of severe illiquidity in the bond market serves to increase the transaction costs associated with purchasing securities when new cash is invested into the funds. Such costs have the potential to reduce a fund's returns and cause tracking error relative to a fund's benchmark.

The funds remain open to existing clients, although given the ongoing volatility in the credit markets we reserve the right to refuse additional purchases if we believe such investments may be detrimental to the other shareholders in the fund. We suggest that clients notify us one day in advance of any additional purchases to give the portfolio manager an opportunity to assess whether the investment can be accepted.

Also, as of February 16th, 2009, purchase fees for these bond funds will be significantly increased (at least doubled).

Source: Vanguard Investments Europe website, February 2009

ANNEX 3

Pre and Post Trade Transparency of non equity markets in Italy.

A) With regards to the situation in Italy, the Italian Government has applied all the principles of MIFID, also to non equity products: these products are submitted to all MIFID rules.
To understand why this has happened in Italy, we should go back to the first years of this century: after the default of the Cirio Bonds (issued from a very well known food company) and the Parmalat Bonds (a food-finance corporation) where hundred of thousand of small private investors lost their savings, the Italian Government decided to give a strong ruling to the market.

B) The occasion was given from the MIFID directive: first of all, all principles of MIFID were applied also to the non equity markets and this decision gave a great transparency to this market.

C) The choice not to leave any self regulation to the market was a very good one because we exactly know what happens when Banks and Finance Institutions are allowed to self regulate themselves.
Due to the existing ruling, even in the financial turmoil of 2008 the Italian market of non equity products has remained liquid and in good health.

D) The control on the market belongs to CONSOB; although there is a strict control, deriving from the Ruling of 2008, the devastating effects of bonds issued from Lehamn Brothers and from MADOFF Groups could not be avoided.
Anyway, a new judicial culture is taking place in Italy: in 2008 CONSOB has been condemned twice by an Italian Court for "Lack of control", concerning Stocks and Bonds issuing. We know that many buyers of Lehman Brother's bonds are suing CONSOB and Patti Chiari (a financial literacy scheme that belongs to ABI- Italian Bank Association that had guaranteed a triple A score to these bonds).
This means that also the Rulers are subject to the control of the Courts.

E) Italian Financial Markets are characterised by high level of transparency, higher than required in other EU Member States; in order to understand the level of transparency requested in non equity markets, you should figure that even in the case that a bond is renegotiated for reimbursement of the term of payment, the issue of a new prospectus is required.

Also Brokers actively co-operate and work to maintain a good level of post-trade transparency.

F) Unfortunately every time that CONSOB requires more transparency, specially with regards to united links insurances, there is an adverse lobby activity on behalf of ABI (Italian Bank Association), ANIA (Italian Insurance Association) and ASSIONIME (Italian association of corporations quoted on the stock market).

Do you know which are the main arguments that they insist on ?:

1) Transparency is a high cost that should be reverted on the small investors;

2) In the rest of Europe there is not a strict ruling on requirements on investments in non-equity products.