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

Fédération Française des Clubs d'Investissement (FFCI) answers

Preliminary remarks

The French Federation of Investment Clubs represents active individual investors, grouped into investment clubs, who are obviously impacted by the "non equity markets transparency" issues.

FFCI considers that this CESR consultation on "non equity markets transparency" bears several serious flaws:

- 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 unfortunately de facto not "market participants" in bond markets (except in Italy). 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 also explains why FFCI cannot express an opinion on several of the questions of this consultation.

- More generally, this consultation is tailored to market professionals and institutional investors, not to individual investors. The very short deadline ignores the very limited expertise resources of individual investors' representatives compared to market professionals. Also, the language used is only English and much too technical. FFCI feels CESR puts individual investors at a clear disadvantage by not allowing for their unequal situation compared to professionals.

- 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 market, which represents the large majority of cash bond markets. FFCI considers that there are transparency issues for Government bonds as well since individual investors have de facto no direct access to this major fixed income market. This lack of direct access to fixed income markets for individual investors is a major issue and reveals a big paradox: why facilitating individual access to the most long term and risky financial asset class (equity market), and not to the shorter term and less risky ones? We would very much like CESR to focus on this fact.

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- CESR has also further narrowed the scope of this consultation on "non equity markets transparency" to post-trade transparency only. FFCI 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.

- This consultation does not include any analysis or questions on the impact of the major fixed income markets failure in 2008 on equity markets. FFCI 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 has played a significant role in the collapse of equity prices last year. It seems the regulated equities markets are a victim of their exemplarity. FFCI believes this is an important issue that should be thoroughly investigated by the financial regulators. 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 characterised 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 wholesale, not retail (except in Italy). 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.

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. The Italian experience 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 already 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.

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 today, 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.

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 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 appallingly low. Second because the much more transparent equities markets are also much more liquid.

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. 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

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

nowadays. As mentioned before, 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)*

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. 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?