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The Committee of European Securities Regulators
Submitted via www.cesr.eu

Transparency of corporate bond, structured finance product and credit derivatives markets

London, February 19th, 2009

Dear Sirs,

Markit welcomes the publication of CESR's Consultation Paper on the *Transparency of corporate bond, structured finance product and credit derivatives markets* and we appreciate the opportunity to provide you with our views on this topic.

Markit is a financial information services company with over 1,100 employees in Europe, North America and Asia Pacific. More than 1,500 institutions use our independent services to value financial instruments, manage risk, improve operational efficiency and meet regulatory requirements. Markit is actively involved in the creation of transparency both through our pricing services for a whole range of financial products as well as through the trade reporting services that we offer for European equities. We therefore feel well placed to comment on transparency-related issues in the credit markets.

Markit's Role in the Provision of Pricing Transparency

For many years Markit has offered pricing services that provide the markets with fair value levels for a variety of financial instruments, with a focus on products that do not actively trade. Today, all major banks, buy-side clients, and other interested parties will use Markit's pricing services to assist them in the process of determining the fair value of their positions and in the preparation of their financial accounts. That said our involvement in creating pricing transparency for the credit products that are covered in your consultation will be mostly based on the following services:

- For European ABS and CDOs, Markit has offered a pricing service since 2005. The service provides daily consensus prices for currently more than 4,200 bonds based on end-of-day book-of-record contributions from all relevant market makers.

- For corporate bonds, we offer a similar consensus-based pricing service that covers more than 3,300 European corporate bonds. Also the Markit iBoxx bond indices include over 3,200 EUR and GBP denominated bonds and provide asset managers with a benchmark and bond pricing. In addition, we are about to launch an evaluated bond pricing service which will provide a much broader global coverage, albeit based on a different methodology.

- For CDS, Markit has offered a pricing service since 2002, which contains daily consensus prices across maturities for 3,300 Reference Entity tiers globally. Furthermore we provide intraday pricing for CDS based on bid/offer quotes sent by the market makers.

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- Given our role as a leading provider of independent pricing services to the market, we are contributing a significant number of our prices free of charge to the various industry initiatives that aim at further increasing the level of transparency in the marketplace. This applies to both European corporate bonds and ABS.

In addition to our pricing services for various credit products, Markit has gained extensive experience in the area of pre- and post-trade transparency for European equities. Our Markit BOAT trade reporting platform consolidates pre- and post-trade data from over 25 leading financial institutions that use the platform to meet their MiFID-related OTC equity reporting obligations for approximately 8,000 stocks listed across Europe. We publish an average daily turnover of € 20bn, which accounts for an estimated 60% of the total OTC equity trade volumes reported in the EEA and 20-25% of the entire equity trading in Europe. Markit BOAT collects, validates, stores and publishes an average of 100,000 trades every day with an aggregate order quantity of more than 1.5 billion shares.

General Comments

We welcome CESR's willingness to listen to the views of the industry and we appreciate the opportunity to provide you with additional information about the various pricing services credited with bringing transparency to the credit markets.

We do agree with your view that post-trade transparency is an important element of efficient and well-functioning securities markets, but by no means the only one. More importantly, the characteristics of the products and markets have to be taken into account when deciding on the appropriateness and the design of a transparency regime. It is therefore worth emphasising a number of crucial differences between the credit products that you consider in your consultation and the equity markets that the MiFID transparency regime has been designed for:

- The credit products covered in your consultation paper, with the exception of corporate bonds, are not widely used by retail investors. This contrasts with the equity markets and has a number of implications for their liquidity as well as for the justification and the design of transparency regimes.

- Most of these credit products, with the exception of CDS, rarely trade and can be regarded as illiquid by their nature. ABS and CDOs in particular have never been actively traded as they are held by only a small number of investors on a buy-to-hold basis. This will have a number of implications:

    - Trade information for these credit products will always be quite sparse. For some instruments such as ABS, probably only 1% to 5% of the bond population trades in a typical week and could therefore be described as reasonably liquid.

    - A specific ABS tranche or corporate bond will often only be relevant for a handful of market participants, each on the buy- and on the sell-side respectively. This situation is particularly pronounced for lower quality tranches of ABS and implies that once a trade for these assets has to be publicised, it will be easy for those involved in the deal to identify both the buyer and the seller of the bonds. The idea of "anonymity" of the counterparties of the reported trades would therefore be a myth.

The existence of the above product characteristics must lead to the conclusion that for the majority of the credit instruments covered in your consultation paper, the upside of post-trade reporting will be fairly limited while, as TRACE-related research has shown, introducing post-trade transparency for these illiquid products might cause additional damage to their liquidity.

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That said we strongly support CESR's willingness to listen to all stakeholders and consider an industry-led solution. We would expect such a regime to be designed in a way that it can deliver some desired enhancements in transparency while largely avoiding unintended consequences.

Part I: Corporate Bonds

Question 1: Do you believe the situation is symptomatic of a market failure?

We are of the view that, while some credit markets have clearly broken down, the lack of post-trade transparency is not to blame for the current market wide problems such as wider bid/offers or sharply reduced liquidity. We therefore find it difficult to understand how you can come to the conclusion that greater post-trade transparency might be useful to remedy the effects of a market-wide crisis.

We agree that the relationship between transparency, competition, and liquidity is complex and has not been sufficiently explored by previous research efforts. The major difficulty with corporate bonds over the last 18 months has been that trading often just stopped. One should keep in mind that more effort has to go into the valuation of products that do not trade and that post-trade reporting can add only very little value.

Question 2: Is there a potential asymmetry of information between market participants?

We share your view that wholesale clients seem to have a sufficient level of transparency in the market for corporate bonds while retail clients might not be in the same position. However, this concern is not new and, in our view, is being addressed successfully by the various transparency enhancing industry initiatives that Markit actively supports with pricing data:

- Markit submits price histories for the Markit iBoxx credit indices and prices for the 1,000 most liquid corporate bonds free of charge to the SIFMA corporate bond transparency initiative www.investinginbondseurope.org. The SIFMA webpage also contains a number of links to our websites allowing users to access additional information about bonds and bond indices.

- In the area of ABS and CDOs, we provide a range of ABS sector spreads, as well as current composite prices and price histories for the most liquid European ABS bonds to the quarterly ESF/SIFMA Structured Finance Industry Report free of charge.

Market liquidity and bid/offer spreads

Questions 3 and 5: Key reasons for reduced liquidity in corporate bonds

We are of the view that both wider bid/offer spreads and reduced turnover for corporate bonds were caused by similar factors, namely an explosion of banks' funding costs, a general de-leveraging trend, a sharply reduced risk appetite of market makers and the resulting massive widening in the CDS/bond basis. The combination of these factors reduced the willingness of market makers to commit capital and balance sheet, i.e. there is very little interest in trading any bonds resulting in very defensive bid/offers.

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Questions 4 and 6: Can post-trade transparency reduce bid/offer spreads?

It seems to us that you confused causes and consequences in your analysis of the impact of the crisis. We are of the view that neither reduced liquidity, nor wider bid/offers, nor the breakdown of the bond/CDS link have been caused by the lack of post-trade transparency. These problems are the result of a reduction in leverage by the banks, a cut down in risk appetite, and sharply increased funding costs. In our view none of these factors can be remedied by additional post-trade transparency either.

In the current market environment, an ill-designed post-trade transparency regime is unlikely to cause market makers to tighten their bid/offer spreads. If anything we would expect it to have the opposite effect: Most market practitioners would agree that the introduction of post-trade transparency for illiquid products reduces the willingness of market makers to commit capital. Given that most credit products covered in your consultation are indeed illiquid, the introduction of a transparency regime for them should be expected to force market makers to widen bid/offer spreads and in an extreme case could lead to a situation where trades are executed on an order basis only.

Questions 7 to 10: The CDS / Corporate Bond Relationship

Whilst one might argue that corporate bond investors should be aware of the CDS spreads for the respective bond issuers, these spreads must be used carefully and can certainly not be regarded as the basis for pricing a bond. Often market participants will compare the CDS spread to the asset swap spread of the bond to develop a view on "relative value", but this approach is only really relevant for institutional investors who can actually invest in both instruments. In the current market environment in particular, the knowledge that a bond trades 100bp wide to the CDS will not provide a reliable indication of whether the bond is cheap or expensive, and whether it should be bought or sold by the investor.

You correctly observed that the increase in funding and balance sheet costs on the one hand and counterparty issues on the other have caused the bond/CDS basis to deviate sharply from ranges observed in the past. While it used to trade in a range of +/-15bp p.a. and a bond was regarded as cheap when it traded at the wide end of this range, we would not expect the basis ever to come back to such a relatively stable situation. We are of the view that the willingness of market participants to own bond/CDS basis at low spread pickups will not return to previous levels anytime soon given the sharply increased awareness of funding risk created by the recent events.

Over the last couple of months it has not been unusual for corporate bonds to be issued at credit spreads that were between 200 and 300bp wider than the comparable CDS spread. Obviously, in such a situation, while having access to CDS spreads might still be of some interest for corporate bond investors, they clearly can not be used to produce a reliable valuation for the bond. Strictly speaking this has always been the case: Even in more benign times, a number of factors were present that caused persistent differences between the CDS and the comparable bond spreads for the same name and maturity. The differences are simply much more pronounced today compared to a tight spread environment.

Finally we do not support the view that the cash bond market has been less volatile while the liquidity in the CDS market has dried up. In contrast CDS managed to maintain liquidity throughout the crisis, while corporate bonds only seemed to be less volatile as they rarely traded. In fact, in the last quarter of 2008, average monthly CDS volumes of the most active dealers surpassed the record levels that had been observed in mid 2007, according to the latest Quarterly Metrics Report which is available on www.markit.com. Given their superior liquidity, CDS remain the more reliable and unbiased measure of default risk of an entity compared to the one derived from the bond spread. This applies even more so today as the rise in banks' funding costs has led to "artificially" inflated bond spreads.

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Valuation

Question 11: Difficulties in valuing corporate bonds

When discussing valuation difficulties for corporate bonds it is worth noting that the number of outstanding bonds is huge and only a fraction of them trades on a regular basis. While a consensus pricing service can provide daily pricing for more than 10,000 bonds globally, only the use of modelling techniques will allow coverage of a much higher number. In addition to our consensus pricing for corporate bonds we are therefore about to launch an evaluated bond pricing service that will provide a significantly increased coverage of corporate bonds, albeit based on a different methodology.

From the perspective of a provider of consensus pricing services, it is worth noting that whilst the uncertainty about the correct price might have increased, the coverage of these pricing services has not really changed over the last two years, with the exception of the rare event when a market maker completely disappeared. The stability in coverage can be explained by the fact that no matter how little trading occurs, each dealer still has to come up with a valuation for all of his positions at the end of every day.

Question 12: Would additional post-trade trade transparency in distressed market conditions help valuation?

The argument that post-trade transparency could make a significant difference to the valuation of corporate bonds in distressed market conditions seems to be flawed for a number of reasons:

- As you correctly stated, trading activity has been significantly reduced and in some areas of the market only 1% to 5% of the total product universe trades every week. If no trading activity occurs for 95% to 99% of the bond population, how will post-trade transparency help to come up with a reliable valuation for these products?

- As both accounting standard setters and market participants have pointed out, many transactions in the current markets might not be representative of fair value, and should therefore not be regarded as "determinative". One might wonder how reported transactions can be regarded as helpful for the purpose of valuations if at the same time users are encouraged by official bodies to disregard transactional prices in the current environment.

- Transactional data will only be truly valuable if the background of the trade is known: Was it a trade between two willing, non-stressed counterparties or was it a forced sale? Was the trade tied to another transaction? Situations where the same bond has traded at very different levels on the same day are not uncommon in today's markets. Your expectation that traded prices would be consistent and accurate thus does not seem to match reality. As the observer has no way of determining which transaction price is "right" and which one is "wrong" without having access to the necessary background information, a trade reporting regime has the potential to create additional confusion instead of clarity.

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Section 3: Potential benefits and drawbacks of increased post-trade transparency

Question 13: Potential benefits and drawbacks

We share the view of many market participants that an ill-designed post-trade reporting regime has the potential to significantly damage liquidity, particularly for less liquid products.

Also based on our experience as the owner of the Markit iBoxx cash bond indices we are of the view that mandatory trade reporting should not be expected to enhance the quality of bond indices:

- For broad corporate bond indices, only a fraction of the index universe will actually trade on a given day, and the portion of frequently traded bonds with multiple daily trades is even smaller. For frequently traded bonds high quality multi-contributor prices are available already while traded prices for illiquid bonds are often not reflective of their real market price and would therefore potentially distort the index.

- Our independent bond indices are based on composite bond prices that we receive from all relevant dealers, overlaid by rigorous control and cleansing procedures. In our experience market makers are willing to provide quotes even on illiquid index constituents as long as their individual prices remain "hidden" through the consolidation process. We are of the view that mandatory post-trade reporting could easily have a negative effect on the availability of bond prices for index calculation as the number of illiquid bonds that dealers quote might be reduced, as described in other sections of our reply. This would result in a reduction of both the number of priced bonds and the number of bank contributions for each bond.

- As mentioned above, the current lack of trading activity in corporate bonds has led to a wider disparity in the quotes that we receive from market makers, requiring us to be more rigorous in discarding quotes for calculating the composite price. We have therefore recently introduced additional controls which allow us to calculate composite prices for more than 90% of the bonds that constitute the index.

- Finally you should be aware of the fact that the quality of bond indices depends on many parameters in addition to the pricing sources, such as their design, the implementation of the index rules as well as the calculation process and methodology.

Question 14: Other main benefits or drawbacks of post-trade transparency

In addition to the liquidity-related concerns that we voiced above, CESR should be aware of the potentially damaging effect that post-trade reporting for debt instruments might have on the overall health of the financial sector.

As you are certainly aware, recent political pressure has caused some relaxation of mark-to-market obligations and guidance from accounting standard setters that encourages users to value positions based on their own assumptions if markets are inactive. The introduction of a post-trade transparency regime for bonds might have the opposite effect: The publication of a transaction at a low price might force holders of the assets to write them down to the traded price even if the transaction was forced or not representative of fair value for some other reason.

In addition recent experience has shown that the same bond can trade at very different prices on the same day, linked to circumstances known only to the parties involved. Anecdotal evidence suggests that price differentials of more than 20 points for the same bond have been observed for trades on the same day. In such a situation, public reporting of the trades will create additional confusion, not clarity, about the fair value of this product.

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Question 15: Experiences with TRACE

While the existence of TRACE in the US has not mitigated any negative effects of the current crisis such as wider bid/offers or sharply reduced liquidity the general effect it did have on the US corporate market was, in our view, the opposite of the project's intent: For market makers in corporate bonds it has always been difficult to generate an appropriate return given the illiquidity of the product even in benign market conditions, and, with credit event risk now greatly increased, it seems almost impossible today. The TRACE information enabled investors to challenge the bid/ask spreads that were charged by traders, which led to a significant reduction in bid/offers. Given the lower rewards and increased risk of market making in US corporate bonds, many smaller firms have exited their market making activities resulting in a highly concentrated business. From what we can see, overall institutional size transaction volume has fallen and when transactions take place, they tend to be larger than in the pre-TRACE era but often occur at levels far from what TRACE price information would have suggested. That said we are of the opinion that the introduction of TRACE seems to have reduced liquidity and true price transparency in the US corporate bond market.

It is worth noting that while the introduction of TRACE might have caused bid/offers for US corporate bonds to fall, it was introduced in a very benign environment and in a market that was not very competitive to start with. As the European corporate bond market has always been more competitive, with tighter bid/offers being quoted despite the lack of a transparency regime, an increase in competition could not be used to justify the introduction of such a regime in Europe.

Furthermore what you regard as a positive impact of TRACE for valuation purposes might actually be a drawback: The decrease in valuation dispersion might not have been caused by a real increase in valuation certainty, but it was potentially just the increased discipline of forcing investors to mark positions to the traded level. The risk here is that a published transaction price will force users to mark their positions to a level that is much less representative of fair value than what they used before. We have voiced this concern in more detail in our response to question 14.

Whilst we do not use TRACE prices as an input into our consensus composites, we will display them in our end-of-day reports for US corporate and convertible bonds. Clients will hence be able to see both a TRACE price and a Markit composite price for the same bond displayed next to each other. Additionally, going forward we will use prices published by TRACE as one of the many inputs for our Evaluated Bond Pricing platform.

Question 16: Other benefits or drawbacks of a TRACE-like regime

We are of the view that while your consultation paper fails to produce sound arguments why the introduction of a transparency regime would actually deliver any tangible benefits, it does not provide a proper analysis of the potential cost either. The TRACE experience has demonstrated that the biggest potential drawback would be a further reduction in market liquidity in the less liquid market segments, as dealers might not be willing to commit capital for trading these products anymore.

In addition CESR should take into account the potentially damaging effect that post-trade reporting might have on the overall health of the financial sector. As you are certainly aware, recent political pressure has caused some relaxation of mark-to-market obligations and guidance from accounting standard setters that encourages the use of internal assumptions for valuation purposes if markets are inactive. The introduction of a post-trade transparency regime for corporate bonds might have the opposite effect: The publication of a transaction at a low price might force holders of the assets to write them down to the traded price even if the transaction was not representative of fair value. Also recent experience has shown that the same bond can trade at very different prices on the same day, linked to circumstances known only to the parties involved. In such a situation, public reporting of the trades will create additional confusion, not clarity, about the fair value of this product.

That said, for credit products that are characterised by buy and hold investors and low liquidity, it is of crucial importance that any transparency regime carefully designed, which certainly cannot be said for

TRACE. Also, as the regime would apply to a section of the European financial markets, its overall design should be based on the principles of MiFID instead of trying to mimic TRACE. As there is no need to defend its competitive position, the TRACE monopoly model is certainly not the ideal set up to deliver innovation, reduce costs, or even listen to its users and other stakeholders. As the principles of post-trade transparency should be consistently applied to the different segments of the European financial markets, a competitive model such as the one used for European OTC Equities where dealers can chose which platform they want to report to, is therefore desirable.

Question 17: Volume declines for 144a securities

As market practitioners will confirm, 144a securities have always tended to be the more complex and less liquid version of a bond. In an environment of sharply reduced overall market liquidity and risk appetite, a more significant impact on the liquidity of these bonds seems rational, and, in our view, cannot be explained by a lack of post-trade transparency.

Section 5 - Market-led initiatives (Questions 18 and 19)

We do agree that market-led initiatives should be evaluated based on the depth and breadth of the information they provide, as well as their timeliness and delivery mechanism, while they should also demonstrate a clear commitment of the industry. That said we would recommend adding "relevance" as an additional factor to be considered. Purely counting the number of bonds that are covered will not allow a judgement to whether the coverage can satisfy the needs of the target audience. We are of the view that providing prices for the most liquid bonds, i.e. those that the public tracks and that a retail investor might want to invest in, presents the best approach to optimising the "relevance" of the coverage.

Markit provides price histories for the Markit iBoxx indices and end-of-day prices for the 1,000 most liquid corporate bonds to the SIFMA bond transparency initiative www.investinginbondseurope.org free of charge. The SIFMA webpage also contains a number of links to our general and index websites which allows users to access additional information about bonds and bond indices.

That said, we are of the view that market led initiatives can successfully address potential information asymmetries in the market for European corporate bonds by providing retail investors with relevant and reliable transparency in this market segment.

Section 7 – Conclusions and Recommendations

We are of the view that insufficient post-trade transparency for corporate bonds was certainly not the key reason behind the difficulties in the market, nor could it be used to solve them. We do agree that the design of an appropriate post-trade transparency regime for credit products is not easy, and therefore strongly support your view that the industry based on its extensive expertise is in a prime position to come up with a sensible solution. Furthermore, we generally support the concept of segmented transparency which is tailored to the target audience, applying different rules to determine the depth and breadth of coverage, the timeliness of publication, and the form of delivery depending on the characteristics of the specific market segment.

Questions 20 and 21: Can post-trade information restore market confidence and liquidity?

As outlined above, we do not think that a mandatory post-trade reporting regime has the potential to restore market confidence. As the TRACE experience has shown, it should be expected to further reduce the willingness of market makers to commit capital for less liquid products. That said, we are of the opinion that an ill-designed transparency regime for products that are illiquid by their nature can reduce market liquidity even in a more benign environment, while in the current stressed markets its introduction might lead to a situation where trades occur on an order basis only.

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Question 22: Are corporate bond markets wholesale or retail markets?

Corporate bonds are probably the only credit product covered in your consultation with a significant involvement of retail customers, even if the percentage will vary between countries. Transparency regimes such as the one that has been introduced in Italy clearly aim at providing more transparency for the retail investor specifically. This is demonstrated by the fact that only trades below a certain threshold are reported. We regard this as an appropriate approach to satisfy the needs of this audience.

Question 23: Benefits and downsides of transparency regime for wholesale / retail

The fact that a post-trade transparency regime provides additional data points will have some benefit for everyone, more so for retail investors though who might currently experience somewhat limited transparency. As mentioned before, wholesale clients should be expected to have access to sufficient pre- and post-trade transparency already, and the advantage for them will thus be less significant.

For less liquid products, both wholesale and retail investors are exposed to the potential negative effects of a transparency regime. Reduced liquidity provided by the market makers, but also the risk that the actual buyer and seller involved in a particular trade can be identified, will be particularly relevant for wholesale investors though given the size of their trades and positions.

Questions 24 and 25: Is the reduced reliability of the CDS a reason for more post-trade transparency of cash corporate bonds? Can it address valuation issues?

As outlined above given the number of fundamental differences between the products and existing market segmentation, we are of the view that CDS spreads could never really be used to price corporate bonds. We therefore do not think that this argument has any real relevance.

We also believe that the importance of trade reporting for valuation purposes is much less significant than some might believe given that actual trading activity is very limited, that many trades occur at distressed levels, and sufficient background information for the trades will not be available. That said, while transactional data should be taken into account for valuation purposes, its importance often proves to be rather limited compared to other reliable pricing sources that are available already.

Question 26: What is the most cost-effective solution: an industry-led regime or mandatory regulatory requirements?

We firmly believe that the industry is willing to cooperate with regulators on the issue of post-trade transparency for credit products. We are therefore of the view that an industry-led solution with an underlying roadmap, similar to the efforts in the area of OTC Derivatives Infrastructure, might represent a sensible approach. Based on a dialogue between regulators and the industry, the parameters of any potential transparency regime should be carefully designed to provide additional transparency mainly for retail investors, while avoiding any undesired reduction in liquidity.

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Technical issues

Questions 27 and 28: Scope, depth, and timeliness of reported information, exact volume

For illiquid corporate bonds, it often takes market makers days, if not weeks or even months, to sell a sizeable position that they have acquired from a client. We are therefore of the view that only a transparency regime that is agreed in dialogue with the industry, and which carefully defines scope and reported information as well as the appropriate use of delays, caps and thresholds can preserve the anonymity of the trades and avoid significant damage to market liquidity.

Also we feel quite strongly that trade reporting should not be used to provide additional details of the underlying bonds. While it is certainly not the purpose of a transparency regime in the first place, it would also massively complicate its introduction while creating little added value as those additional details are mostly provided through other channels already.

Question 29: Step-by-step implementation

We are of the view that a step-by-step introduction of a transparency regime might be advantageous, as it would give the reporting dealers time to implement the appropriate systems and potential errors could be dealt with at an early stage. Additionally, it would allow regulators and market participants alike to explore the various consequences of the reporting regime before deciding on whether it should be applied to additional market segments.

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Part II: Structured Finance Products and Credit Derivatives

Section 6 – The role of post-trade transparency

Questions 30 and 31: Information relevant and available for pricing

The price information that is relevant for price discovery and valuation of Structured Finance Products (SFPs) will generally be provided from a variety of sources such as dealer runs, CDS of ABS, as well as consensus-based, cash-flow based, and model-based pricing services offered by a number of providers.

Vendors of pricing services for SFPs will typically provide two distinct approaches which are model-based pricing and dealer-contributed consensus pricing, while cash flow models are mostly used to create the relevant inputs for them. Typically market participants would use a commercially available or an internally built cash flow model into which they input various assumptions per deal, e.g. the prepayment rate, the default rate, and the spread, to then solve for the implied price of the bond. While different firms will mostly use the same cash flow model for a specific deal, parties can differ in their valuation based on their individual assumptions. Model-based pricing uses cash flow models, other inputs, and generic assumptions per asset class to derive a theoretical price. It is worth noting that for both cash flow and model-based approaches, the implied price can deviate from the market price which will ultimately be driven by supply and demand.

Consensus Pricing Services

In addition to these approaches, consensus pricing services play a particularly important role for the pricing of illiquid products such as SFPs that are dominated by buy-to-hold investors. Please find below an overview of the relevant pricing services that we currently offer for this market segment:

1. European SFPs

Markit's European ABS pricing service produces daily prices for more than 4,200 European securities. Coverage tests have shown that this number represents more than 80% of the bonds that are relevant to ABS investors. All prices are based on end-of-day book-of-record contributions from market makers. After applying a number of cleansing algorithms to remove stale data and outliers, the published consensus prices will just be the average of the remaining contributions. These prices are therefore neither model-based nor manipulated in any other way. Please note that in addition to consensus prices we will not only publish the actual contributions that were accepted but even the ones that were rejected. This is to maximise transparency for users of the service.

CDS of ABS spreads are often used as one of the inputs to pricing ABS. In addition to our US CDS of ABS pricing services, Markit is currently developing a European CDS of ABS pricing service to aid transparency in this emerging asset class. The service, which is expected to be launched in Q1 2009, will be based on spread feeds from all relevant dealers allowing the creation of composite levels for around 120 instruments.

2. Synthetic CDOs

The results of the Markit Totem price verification service will often provide the starting point for the pricing of synthetic CDOs. Within Markit Totem, we poll market makers for their pricing of the entire capital structure of 27 global portfolios at the end of every month. The results of this price verification service are available to market makers that contributed prices and whose contributions were accepted. Additionally we will provide investors with valuations for their synthetic CDO positions based on broadly accepted models that are calibrated to the Markit Totem results on a regular basis.

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3. Markit Valuations Manager

Finally, you should be aware of Markit Valuations Manager, a tool that we think will be at the core of an industry-led solution to significantly increase valuation and pricing transparency in the entire market, including SFPs. Based on the support of key market makers and with a view to consolidating all available pricing data in one place, Markit Valuations Manager has been designed to offer a central source of all available valuation information to clients. The service compiles multi-dealer marks and allows users to compare individual bank contributions together with Markit's independent composite price. Markit Valuations Manager currently includes most regular credit products and will be expanded to also cover SFPs during the second quarter of 2009. The service is expected to work in conjunction with Markit's other Structured Finance offerings as detailed above.

All said we are of the view that the wealth of pricing sources and commercially available services provide a largely sufficient level of pricing transparency for SFPs.

Question 32: Benefits and downsides of post-trade transparency for ABS

As described above, we are of the view that commercially available pricing information is largely sufficient to allow price discovery and valuations for ABS. We feel that a trade reporting regime would make little difference to most market participants given that trading activity in this market segment is very limited, as it has always been, even in the most benign environment. In contrast to coverage by the services currently present in the market, only a very small portion of the whole universe of SFPs ever trades, e.g. according to dealers less than 50 bonds in the asset class of European SFPs every week. This must lead to the conclusion that no matter how a transparency regime for European SFPs is designed, its "coverage" will always end up to be minuscule in contrast to the one that exists through a variety of established pricing sources and services already. That said we feel that the provision of some additional data points from transactions will only carry limited value, also taking into account that many trades will occur at distressed levels and might therefore not even be representative of fair value.

In more general terms, we are of the view that the importance of transactional data is often hugely overstated compared to other sources of pricing. The paragraph on *The Relevance and Reliability of Different Pricing Sources* in the CDS section provides an in-depth discussion about the value of transactional data compared to other sources, and why a trader does not, and never actually should, submit a transactional value as the end-of-day book-of-record price.

Finally, the risk that a post-trade transparency regime might damage market liquidity is particularly pronounced for illiquid instruments such as ABS and CDOs, and even the most careful design of such a regime might not be sufficient to mitigate this potential downside.

Questions 33 and 34: Include all types of ABS or use segmentation?

Whilst we do have significant doubts about the justification for a transparency regime for European ABS to start with, any rules considered for this asset class should follow lines similar to the ones discussed for corporate bonds, aiming to provide some desired improvement in transparency while avoiding damage to liquidity.

In our view the scope of a transparency regime for SFPs can only be the subsection of the market that is reasonably liquid, standardised, and of higher credit quality, while smaller, lower quality, stand-alone deals cannot be covered. It would therefore be necessary to define a number of criteria such as asset class, rating, and minimum issue size to identify bonds that might be suitable. Within the universe of ABS it will probably only be the AAA rated RMBS and CMBS bonds from regular issuers that could qualify. The big question is whether, in the current environment, the number of bonds that are reasonably liquid, even if liquidity is generously defined, will actually surpass 50 to 100 for each region, and whether the introduction of a post-trade transparency regime for such a small number of bonds could justify the effort.

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Questions 35 and 36: What post-trade information should be published? Timing of reporting

We are of the view that any potential post-trade transparency regime for ABS should broadly follow guidelines similar to the one that could be used for corporate bonds, while reflecting in its parameters the much lower liquidity of ABS.

Question 37: Connection with other regulatory interventions

We share the view of regulatory bodies that a number of deficiencies that need to be addressed have become apparent in the area of SFPs and we have therefore actively participated in initiatives that aim at increasing both transparency and standardisation of the asset class:

- Markit provides all relevant ABS sector spreads, as well as current composite prices and price histories for the most liquid European ABS to the quarterly ESF/SIFMA Structured Finance Industry Report free of charge.

- In addition, Markit is in the process of creating a European Transparency Platform to provide centralised access to offering circulars and investor reports for European ABS free of charge.

- Markit has been offering a European ABS Collateral Performance reporting platform for over eight years. We currently publish more than 25,000 standardised reports detailing the pool, the bond and the credit enhancement performance for 1,400 live deals across all asset classes of European ABS. We calculate and display the original credit enhancement as well as the ongoing credit support for each bond in a deal.

That said we are of the view that investors will need a clearer picture of the collateral issuance and up-to-date performance data for specific deals to be able to properly access valuations. Standardisation and timeliness of reporting across European ABS should be the focus:

- Additional loan level information from issuers might help pricing transparency and create more standardisation in valuing SFPs particularly when using model based pricing approaches. In comparison to the US market, Europe lags significantly in terms of availability of loan level information as it is only published for a small number of deals such as UK non-conforming RMBS. We feel that market participants would benefit from having this data made freely available while the tools to analyse the data would also have to be built and provided by the vendors.

- In our opinion, the timeliness of trustee reporting in Europe also falls short compared to the US. In certain cases, it takes trustees of European deals a number of weeks to provide reports for the latest payment date. As a result, market participants will not be able to use the most up-to-date bond and deal data when making investment decisions. Central sources of trustee reports will enable investors to access whatever information is available and also creates awareness of how frequently deal updates can be expected.

All said we do not see why and how these various ongoing efforts need to be linked to the discussions about post-trade transparency for the asset class. We are of the view that other initiatives should be kept separate to allow for a speedy and efficient resolution of each of the respective issues. If anything, the successful implementation of other transparency or standardisation increasing measures for SFPs would reduce the need for the introduction of a post-trade transparency regime for this market segment.

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CDOs

Questions 40 to 45: Benefits and downsides of a post-trade transparency regime for CDOs

The market for CDOs has always been fairly illiquid given the heterogeneous nature of the bonds, the time of analysis needed to decide on an investment, and the small issue sizes of many of the tranches. As a consequence there is only a small number of players for every bond, both on the buy side and the sell side, and a market maker will need days, if not weeks or even months, to sell a CDO position that he acquired from a client. The willingness of dealers to provide a firm bid for a CDO tranche will depend on their ability to sell the bond without its price moving significantly in the meantime. Given the small number of relevant parties, post-trade reporting for CDOs will allow other market participants that were not involved in the reported trade to identify the buyer as well as the seller of the bonds. For CDOs, this resulting loss of anonymity created by post-trade transparency should be expected to significantly reduce the willingness of dealers to provide firm prices.

As you correctly stated, a number of third party valuation services are available for CDO pricing while the results of the Markit Totem service will often provide the starting point for the pricing of synthetic CDOs. Within Markit Totem we poll market makers for their pricing of the entire capital structure of currently 27 portfolios at the end of every month. The results of this price verification service are available to all market makers that contributed to the service and whose contributions were accepted. Additionally we provide investors with valuations for their synthetic CDO positions based on broadly accepted models that are calibrated to the Markit Totem results. Whilst cash CDOs are part of our European ABS pricing service, the coverage for this asset class is somewhat limited, given the small number of dealers pricing each bond.

In our view, whilst the concept of applying a transparency regime only to the liquid segment of the market is generally a sensible approach, the number of CDOs that could be described as reasonably liquid is probably close to zero. Furthermore, there is no such thing as a "vanilla" CDO, as deals tend to be quite bespoke and there will generally be very little trading, no matter whether it is a cash or synthetic deal. If a trade occurs, it is often only relevant for a very small number of investors, who will probably hear about it anyway.

That said there is a significant risk that trade reporting for CDOs would destroy market liquidity completely, i.e. market makers would not show firm bids anymore and transactions would only happen on an order basis. This is the opposite of what is required to restore a functioning market.

Question 46: Post-trade information regime for inactive markets

While we can not imagine how a post-trade reporting regime should be designed to deliver any benefits for products that do not trade, we do have a view on what the appropriate transparency creating alternative would look like: The best way to determine the value of a product that does not trade will be to ask the experts that quote prices for it, aggregate this information, and make it available to the market. Needless to say that this represents a fairly accurate description of a consensus pricing service based on end-of-day book-of-record prices supplied by the market makers.

Question 47: Can observable prices helping to test or promote valuation models?

We agree with the view of the IASB Expert Advisory Panel in its report on *Measuring and disclosing the fair value of financial instruments in markets that are no longer active* that users looking to value illiquid products should take all sources of pricing information into account. While transaction prices should be used as one of the sources if they are available, it is of crucial importance that the user has the ability to "look through" these prices, i.e. understand the background of the transaction. Knowing that a CDO tranche has traded at a price of 30 by itself provides little help in coming up with a reliable valuation for this bond, if the user is not able to confirm that this trade was not a forced sale, neither was it tied to another trade, as otherwise the traded price can not be regarded as representative.

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As to the usefulness of transaction prices as input to models, it is worth clarifying their role for the different CDO pricing techniques:

- Cash-flow modelling is based on standardised cash-flow waterfall models for the particular deal structure, with dealers using their individual cash flow assumptions to derive a theoretical price for a bond. Transaction prices are not relevant for this approach.

- Model-based prices are derived from a variety of inputs including transaction prices. However they are only one of the inputs relevant for the modelling of CDOs amongst at least a dozen others. Also, using transactional prices as input for models without understanding the background of the transaction might often lead to the wrong results.

In general terms it is worth noting that our pricing services increasingly use additional sources of data, including transaction prices where available, to validate our end-of-day prices and maximise their quality. However, if both prices are broadly similar the consensus price will have been validated, while if they diverge there simply is no validation. Changing the consensus price to match the transaction price would in our view not be justified as long as the background of the transaction is not known, or the market might have moved between the time of the transaction and close of business. There is no reason to believe that the transaction price carries any more useful information than the consensus price which is based on contributions from all dealers which will have most likely incorporated their expert view on these transactions anyway. Please see *The Relevance and Reliability of Different Pricing Sources* in the CDS chapter for more details.

ABCP (Questions 51 to 55)

Whilst Markit provides pricing services for most credit products, this is not currently the case for ABCPs given both the limited activity in this market and the lack of client interest in the past. ABCPs, even more so than any other product covered in your consultation paper, have been defined by their buy and hold nature, while their short maturities and high ratings caused most of them to trade close to par anyway, at least before the start of the crisis.

We are of the view that the limited turnover and the current dislocated nature of this market imply that neither consensus pricing services nor post-trade transparency regimes can be applied to ABCPs. That said we have been actively involved in restructuring initiatives for some major ABCP markets and we are very open to a discussion on how a transparency enhancing pricing service could be designed and implemented for this asset class.

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CDS (Questions 56 to 61)

General Comments and Markit's Role

Markit provides both intraday and end-of-day consensus prices across the whole maturity spectrum for the vast majority of traded CDS names, currently more than 3,300 entity tiers globally. Our Quotes service is based on the bid/offers provided by dealers on their runs, while end-of-day consensus prices are derived from book-of-record contributions from all active market makers. Our CDS pricing services are used by clients for price discovery and valuation purposes.

Given the wealth of CDS prices that are provided both by the dealers and by data vendors, we are of the view that the existing pre- and post-trade transparency for CDS is very high. Furthermore, we think that, in the context of post-trade transparency, it is essential to take the following characteristics of CDS into account:

- CDS are, and will probably always be, a product that is used exclusively by institutional clients. Retail clients will never be able to trade credit derivatives given the issues related to counterparty risk and the complexity of CDS documentation.

- Also, there is no sign of a market failure for the CDS market which has worked very well and stayed liquid throughout the crisis. This is all the more remarkable as this probably cannot be said for any other financial market, including those that have traditionally been regarded as prime examples of well functioning and efficient.

The Relevance and Reliability of Different Pricing Sources

On several occasions you correctly observed that neither bid/offer quotes nor book-of-record prices necessarily represent actual trades. Whilst we do agree that the availability of transaction prices might be useful to a certain extent, we are of the view that the relevance and reliability of transaction prices is often hugely overstated compared to other pricing sources:

- Only a very small fraction of the total universe of relevant names and maturities of financial products ever trades on a typical day. Even if the 5-year CDS referencing name A has traded knowledge of this transaction price will not enable investors to come up with a spread for the 4.5-year, 3-year, or 10-year maturity. Only a consensus pricing service based on contributions from market makers for all maturities across the curve will be in a position to provide this information to the market.

- Whilst you correctly state that dealers do not submit transaction levels as their end-of-day book-of-record price, we think that this idea should not even be considered as it is wrong to assume that a recent transaction price would be the most reliable indicator of the current level. In contrast, as market makers would confirm, the fact that a product has traded at a certain level will represent a strong reason for the current price to be different. To use an example: if the mid market price for a CDS on name A was 100bp, and a client sold a large amount of protection to the dealer at 100bp (transaction), the new mid market spread at the end of the day would probably be just 98bp (book-of-record price). Using the 100bp transaction price for the end-of-day valuation would clearly be inaccurate.

- Whilst dealers do not submit transaction prices to consensus pricing services, any trades that they have observed during the day will have an impact on where they set their book-of-record prices for that name and maturity, as described above. Furthermore, dealers will also incorporate the trades that they have observed into their marks for other maturities and even for other names in a knowledgeable fashion: While the dealer in the above example will mark the 5-year point at 98bp at the end of the day, he will probably also lower spreads on other maturities for name A, and most likely not just by 2bp for all maturities, but reflecting his view on the shape of the curve. Also, he will probably lower the CDS spreads

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for other names in the same industry that have not even traded on that day reflecting the trade in name A that he has observed.

To summarise the implications of the above example, while just one transaction occurred at 100bp for the 5-year CDS referencing name A, book of record contributions will not only reflect the accurate close of business mid market spread for this specific point at 98bp, but will also provide updated spreads for all other maturities on name A, as well as for other related names.

Existing Transparency for CDS

We are of the view that participants in the CDS market have a very high level of transparency both pre- and post-trade already, given the number of dealer runs and market commentaries that are broadly available, as well as the intraday and end-of-day spreads that are provided by pricing services.

Whilst we agree with your observations that the spread relationship between CDS and bonds seems to have broken down, we would argue that this relationship should have never been assumed as stable in the first place. As the CDS spread cannot be used to derive an accurate valuation for the related bonds, it is unclear how much value there is for a bond investor, be it retail or institutional, in having access to CDS levels. It could even be argued that for retail investors in corporate bonds, knowledge of the CDS spread will create more confusion than clarity.

To conclude, we cannot identify a market failure or any other reason to justify the introduction of a post-trade transparency regime for CDS. We are of the view that for the liquid segment of the CDS market, which consists of CDS and tradable credit indices, a very high level of transparency exists already. A mandatory transparency regime would therefore not provide any meaningful upside, while it would certainly cause significant introduction costs.

We hope that our comments are of value to you. Please do not hesitate to contact us if you require further information or if you want to discuss any of our comments in more detail.

Kind regards,

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