ABI Association of British Insurers

ABI Response to CESR Consultation Paper, Non-Equity Transparency, CESR/07-284 May 2007

Introduction

The Association of British Insurers (ABI), is the trade association for authorised insurers operating in the United Kingdom. As a result of protection, pension and savings products provided by these companies, their fund management arms manage assets of the order of £1,200bn (€1,700bn) across all financial asset classes. These fund management companies also manage financial assets on behalf of third parties such as pension funds.

ABI members, as insurers, manage fixed income assets of £500bn (€700bn) of which one third are non-UK assets.

We welcome the opportunity to respond to this Consultation Paper and to have participated in the Open Hearing of 30 May. This response should be read in conjunction with our response to the CESR Call for Evidence, CESR/07-10, of February 2007 and the earlier EU Commission Call for Evidence of June 2006. We also note the independent academic contribution to this debate, partly funded by ABI together with other trade associations and the Corporation of London, in the form of recent studies of the European government, corporate and high yield bond markets.

The principal elements of these earlier responses were our views that:-

- there is no evidence of market failure in the bond markets with respect to markets transparency;
- that these markets work well and demonstrate an ability to innovate;
- that in dealer-dominated markets there is a trade off between liquidity and transparency and our concern that any regulatory intervention in the area of transparency could impact, intentionally or otherwise, on liquidity; and
- we opposed segmenting the bond markets with respects to transparency.

General Comments

We broadly welcome the Consultation Paper as a balanced contribution to the debate. We continue to oppose mandatory transparency. We believe the markets continue to demonstrate the ability to evolve technically and adapt best practice.

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

We remain of the view that there is no evidence of fundamental market failure in the secondary bond markets. We note (paragraph 20) CESR's comments on feedback from private investors to its earlier Call for Evidence and its retail investor workshop of 12/13 February 2007. We consider the view recorded that low levels of direct retail investment were due to low levels of transparency as too simplistic (see below). We note the industry initiatives under consideration to provide greater information to retail investors.

We welcome the general analysis of market failure by CESR's network of economists, ECONET. This, together with the debate at the Open Hearing, particularly around the concept of public good, demonstrates the complexity of the issues. Time has not permitted us to review with the ABI membership these philosophical and theoretical arguments. We anticipate returning to them in the future consultation exercises

As institutional investors we believe that transparency levels broadly meet our requirements; in previous submissions we have indicated that some increase in post-trade transparency would be welcome. However, we do not expect a perfect solution. Markets, to meet their purpose, should be dynamic and innovative and we expect to see them evolve over time. Any snapshot at a particular moment, if considered in isolation, might lead to a conclusion that structures were sub-optimal. But a fit-for-purpose outcome is more than acceptable if the markets demonstrate the ability to evolve and adapt. It is our view that the markets have demonstrated this ability.

In respect of the proposition, put forward in paragraph 28, that an increase in transparency would be beneficial to smaller participants, we would make the following points. Institutional investors are serving their underlying individual clients, providing indirect access to the bond markets. Where there are sales to the retail market these are primarily (at least in the UK) on an advised basis. The proposition that increased transparency would automatically lead to greater direct retail participation in the bond markets seems at best tenuous. As suggested at the Open Hearing US experience does not seem to support this. This does not seem surprising given the range of alternative financial assets available to retail investors, their diverse characteristics ranging from compensation provisions to tax advantages, which provides similar financial outturns to bond investment in the capital markets.

In the longer term, bearing in mind European policymakers concerns with pension provision, a greater participation by retail investors in the bond markets could be considered a natural development. Industry concerns that retail investors should be properly informed and educated about these markets, pace the ICMA and SIFMA proposals, are a recognition of this trend. In the meantime we would agree with the CESR conclusion (paragraph 28) that if there is to be any increase in transparency it 'will need to be carefully tailored to ensure that liquidity provision and levels of competition were not damaged' and should only be considered after a thorough cost-benefit analysis.

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

We agree that increased transparency should be mandated 'only if the associated benefits would outweigh the cost to market participants'. We reiterate our concerns as to the trade off between liquidity and transparency. We highlight again the conclusions of the recent academic studies of the corporate and high yield markets that any mandated change in transparency in these markets needs careful consideration and would best be limited to post-trade transparency. In addition any imposed transparency would need to be carefully assessed from the viewpoint of the extra costs to all markets users that its provision would entail and also take into account that intermediaries serving the retail sector already benefit from greater transparency levels than those generally available to the individual retail investor.

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

We do not consider transparency as a substitute for appropriate Conduct of Business regulation for investor protection purposes. We await, with interest, the introduction of MiFID. We consider that it should be given some time to bed down before any other changes to the markets are considered.

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

We find it difficult to assess this question at this stage. As already noted direct retail access, CESR's main focus in Section 5, is low in the UK. As institutional investors we provide indirect access to the bond markets for our beneficiaries. We are satisfied that we can continue to provide best execution to our customers. In respect of other intermediaries there does seem a likelihood that MiFID best execution requirements could bring about an increase in the level of transparency.

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

We believe that a multiple approach is required covering regulators, the financial services industry in general and individual product providers. We are aware that ICMA and SIFMA, amongst others, are developing industry initiatives. In the UK on the buyside both the ABI and the IMA (the Investment Management Association) have fund classification systems designed to assist comparate evaluation by intermediaries and end investors.

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

We agree that the defaults of recent years have been the result of factors other than transparency. It is difficult to see how transparency would have mitigated the position for retail investors. A more likely safeguard would be changes in ratings by credit rating agencies, which itself is compromised in cases of fraud. More important is the risk to retail investors of instruments with weak covenants

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

We remain opposed to segmenting transparency requirements in the bond markets and consider it inappropriate.

This is on several grounds. We believe there would be practical difficulties in defining the parameters of such a system and keeping them up-to-date when markets are dynamic and can evolve rapidly. In such a scenario it seems likely that a centralised system might be expensive to operate (for what benefit?) and difficult to adapt to the national markets within the EU. Any system involving threshold is likely to introduce artificial levels. An ill-adapted and rigid system might to lead to distortions in investor behaviour which could be perverse to their long term interests.

Q8 Do you agree that we have captured the most important criteria that the Commission should take into account in judging possible self-regulatory initiatives. If you think there are other factors that should be noted, please provide details.

We agree that the criteria suggested are appropriate for judging any initiative proposed by the industry. We agree that the issue is more one of who is best placed to deliver the right solution. However we would caution that a 'solution' presupposes a problem. A more rational consideration might be that efficient markets continually evolve and that this, generally, is best left to market participants, in the absence of any clearly identified market failure.