

## RESPONSE

### Non-equities markets transparency

#### **Call for Evidence – Ref: CESR/07-108**

1. The European Banking Federation (EBF)<sup>1</sup> welcomes the opportunity to provide input into CESR's call for evidence in respect of non-equities markets transparency. The EBF considers this issue to be extremely important for it could have a strong bearing on the scope and application of MiFID in the future and more pertinently the structure of Europe's markets, and in particular the retail markets, in the "post-MiFID world."
2. The EBF actively participated and made representations in **CESR's Wholesale Day** of February 2006 which approached some of the issues under consideration in this current call for evidence. The EBF has also engaged with the **European Commission** on this same subject and responded in full to its call for evidence consultation of June 2006.
3. It is not the purpose of this current response to reissue the same response to CESR as we previously gave to the European Commission. Nonetheless, it is worth noting that there will undoubtedly be areas in common between the responses to the respective CESR and European Commission call for evidence papers.

#### **I. General remarks**

##### *The issue*

4. Going to the core of the issue, we understand that the European Commission is primarily considering **pre- and post-trade transparency in non-equity markets as a tool to protect retail consumers**. If this is indeed the intention of the current review then the EBF believes that **this rationale is fundamentally flawed**.<sup>2</sup>
5. Notwithstanding the fact that the EBF cannot identify a market failure which would warrant the introduction of mandatory pre- and post-trade transparency, we argue strongly that **market transparency is but one pillar of many for effectively and appropriately protecting consumers** from undue equity risk. But when it comes to protecting consumers from undue risk from non-equity products, the value of pre- and post-trade transparency becomes notably limited.

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<sup>1</sup> The European Banking Federation (EBF) is the voice of the European banking sector representing the vast majority of investment business carried out in Europe. It represents the interests of over 5,000 European banks, large and small, from 29 national banking associations, with assets of more than €20,000 billion and over 2.3 million employees.

a.i.s.b.l. <sup>2</sup> The views expressed in this response do not reflect those of the Italian Banking Association (ABI).

6. MiFID introduces the notions of “**suitability**” and “**appropriateness.**” We believe that it will be these considerations by firms towards their clients under the forthcoming MiFID regime that will effectively and appropriately protect consumers. We do not therefore see the value added of applying a pre- and post-trade transparency regime designed for the equities markets to the characteristically and structurally distinct non-equity markets if consumer protection is the stated rationale for doing so.
7. Moreover, European non-equity markets are characterised by having multiple places of trading. Non-equity products are not traded in the same way in all European jurisdictions. Therefore, **we question why it would be deemed appropriate to have European level action for markets that are organised in rather non-uniform ways and in multiple centres.** Since regulation should follow and not dictate market structures, we fail to see how European level action could be tailored to the very unique specificities of each non-equity market in Europe at this current time.

#### *Time considerations*

8. First and foremost **the EBF considers that now is not the opportune moment to consider a review the scope of MiFID** before it has been fully implemented across Europe. The EBF considers this topic to be of great importance given its potential implications for market structure and the consequences of regulatory intervention thereon. However, at this current time when banks are focusing squarely on implementing MiFID before the 1 November 2007 deadline, industry simply does not have the resources or sufficient time to dedicate the attention that this issue deserves. Vital experience can be gained from the implementation of MiFID to those classes of instrument as currently foreseen by the Directive and with the benefit of this experience a review of the nature set out under Article 65(1) could then be more appropriately tackled.
9. In response to the European Commission’s call for evidence the EBF made this point strongly and called on the Commission to **consider postponing any judgement and subsequent policy decisions in respect of transparency in the non-equity markets until the financial industry and regulatory authorities could make a fair assessment of the effectiveness of systems and the opportunities MiFID is designed to deliver.** We ask CESR to take note of this point of departure which is important as it sets the tone for the rest of our response.
10. In any event, **Europe’s banking community does not currently have evidence of market failure in the non-equity markets.** Moreover, the foreseen provision of investment advice under MiFID will to a large extent alleviate potential information asymmetries between the seller and the buyer, broker and (retail) client, of non-equity products;
11. Consequently, we believe that CESR, as a result of answering the questions the European Commission has asked of it, **could not justifiably conclude that policy**

**intervention at this stage in respect of mandatory pre-trade transparency in the non-equity markets would be necessary.**

12. Transparency in **post-trade reporting may be possible but we remain to be convinced as regards the market failures mandatory post-trading rules would address.** Moreover, current arrangements in the Member States appear to be working well and we do not see the need for a common EU post-trade reporting regime at this current time. Clearly, non-mandatory, self regulatory solutions would be more appropriate.

### **III. Specific remarks**

*1) Does CESR consider there to be convincing evidence of market failure with respect to market transparency in any of the instrument markets under review?*

13. Some commentators have highlighted asymmetries of information in respect of price formation in the non-equity markets as a possible failure of the non-equities market. In response to this assertion **the EBF would argue that asymmetries of information in respect of price formation in the non-equity markets do not represent a market failure per se but rather a necessary characteristic of this particular market.** Obtaining the right amount of information is part of the market process. At the same time, this information asymmetry is the main driver for market participants to supply liquidity to the market.

14. The EBF believes that the non-equity markets, especially the cash bond markets where we understand the European Commission has focussed its interest, generally work efficiently and in manner that has evolved over time to best suit the nature of the instrument and the relatively (compared with cash equities) low levels of liquidity in the markets. **Non-equity markets are generally considered to be efficient since users can make explicit preferences within the market, there is healthy competition and the markets are evolving.** This statement also implies that the levels of opacity in the non-equity markets do not necessarily hinder the price formation process but are in fact a necessary feature of a market where primary dealers need cover to risk capital and take positions.

*2) What evidence is there that mandatory pre- and post-trade transparency would mitigate such a market failure?*

15. In light of the answer to question 1, where we do not identify significant market failures in the non-equities markets, a more appropriate question would be, **how far could mandatory pre- and post-trade transparency eliminate market inefficiencies** (if they can be proven to exist) and enable all classes of investor, including retail investors, to enter into the non-equity markets with an appropriate degree of protection.

16. Firstly, **pre-trade transparency should be decoupled from post-trade transparency** for the purposes of this call for evidence and the European

Commission's review under Article 65. Although related by objective, in terms of practical application to today's generally well functioning non-equity markets, pre-trade transparency would be significantly more difficult to apply than post-trade transparency. That is not to say that the application of post-trade transparency would be straightforward, or necessarily beneficial to protecting investors for some asset classes.

17. Secondly, mandatory pre-trade transparency could, in terms of investor protection, alleviate information asymmetries and thereby enable (retail) investors to verify if they have received best execution and aid periodic fund evaluation. However, this could come at a significant **cost to (wholesale) market efficiency**, to the extent that liquidity could be driven from the market which would clearly be contrary to all investors' interests in the long run.

18. Therefore, we would ask CESR to look at the possible impact mandatory pre- and post-trade transparency could have in the round; that is to evaluate the possible gains to protecting investors against the potential cost to market efficiency. In sum, **we are doubtful that there is sufficient evidence that mandatory pre- and post-trade transparency would appropriately mitigate the limited market inefficiencies in the non-equities markets.**

*3) To what extent can the implementation of MiFID be expected to change this picture?*

19. Europe's non-equity markets are maturing and have tailored their transparency requirements to the market need. **The impacts MiFID will bring to the Europe's markets, both in terms of protecting investors and increasing competition therein will be significant but as yet not easily quantifiable.**

20. The banking community would argue that the non-equity markets must mature in an organic manner and public policy makers have a responsibility to ensure that the (legislative and/or competitive) conditions are ripe to allow for such market developments to occur. Therefore, it is **too early to tell how far market developments as a result of MiFID implementation will make it theoretically possible, if not easier, to have a relatively inexpensive extension of mandatory transparency**, or indeed to render mandatory transparency unnecessary.

*4) Can CESR indicate and describe a significant case or category of cases where investor protection has been significantly compromised as a result of a lack of mandatory transparency?*

21. Please see our general remarks, paragraphs 4 to 7.

*5) Could it be feasible and/or desirable to consider extending mandatory transparency only to certain segments of the market or certain types of investors?*

22. Firstly, by way of principle we would **strongly support there being a prioritisation by market segment or by type of investor** as not all class of non-

equity products or their markets are characteristically uniform, nor is retail investors' exposure to those products or markets.

23. It is also right to follow the principle that **policy should be driven by where potential investor protection concerns are most prominent**. This approach assumes to a certain extent that there is a sufficiently significant risk to investors from the present arrangements foreseen under MiFID, where market transparency is limited to equity products. In line with this principle, we would expect the CESR's policy recommendations to be informed by empirical data regarding the exposure and the projected exposure over time of retail investors to non-equity products as compared with wholesale participation in non-equity markets.

24. The EBF considers it important for CESR to explicitly mention the **market efficiency policy rationale** in any recommendations it makes. CESR, through its members, has responsibility to protect investors but the emphasis which it places on investor protection must be evaluated against the efficiency of the single market and its competitive position in the global economy.

6) *What criteria does CESR recommend should be applied by the Commission in determining whether self-regulatory solutions are adequate to address any of the issues above?*

25. First of all, **the burden of proof rests on CESR and/or the Commission to demonstrate where market failures have occurred** and if they could have been solved by mandatory pre- and post-trade transparency in those markets. Importantly it should be clearly assessed if these failures due to an absence of public policy action.

26. Assuming market failures could be identified and assuming they were not due to the absence of public policy, then a case could be made to propose, at most, self regulatory solutions.