



BRITISH BANKERS' ASSOCIATION

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BBA RESPONSE TO CESR CALL FOR EVIDENCE CESR/07-108 NON-EQUITIES MARKETS TRANSPARENCY

The British Bankers' Association represents more than 260 banks carrying on business in the United Kingdom. The majority of these banks come from outside the United Kingdom and our members cover the whole range of investment services. They are particularly active in European cross border markets. The BBA is the principal banking association in the UK and speaks for banks representing 95% of the banking assets held in the UK.

We welcome the opportunity to respond to CESR's Call for Evidence on Non-Equities Markets Transparency. Article 65 of MiFID requires that the European Commission carries out a review of the transparency arrangements for a number of markets. We support this concept being embedded within the Directive. However given the eighteen month delay that has been instituted to the implementation of MiFID – to November 2007 - it no longer seems an appropriate time to consider transparency. Our members would strongly suggest that CESR response to the European Commission should be that an equal delay of eighteen months be instituted for the Article 65 reviews. In the absence of hard evidence of the operation of the transparency provisions, (systematic internalisers, liquid shares etc) for equities it will be very difficult to analyse the impact of bringing in these provisions.

We would encourage CESR to take a better regulation approach to transparency. That is, not to take any regulatory action in the absence of clear market failure and to only consider changing those aspects of the rules on transparency for non-equities markets which on a cost benefit analysis approach will bring a net benefit to the industry (including clients). This should take into account the cost, in both human capital and monetary terms, of changing from the current state.

We would also draw CESR's attention to the FSA Feedback statement FS 06/04 – for their discussion paper DP 05/05. We would highlight a number of the FSA's conclusions:

1. 'We still consider that transparency is not an end in itself, and that the ultimate aim should be to have markets that are fair, orderly and clean. As a result, we have maintained our focus on whether there are failures evident in the way the markets currently operate and, associated with this, the role that transparency plays in delivering efficient markets.'

2. 'We do not see any evidence of substantial market failures related to transparency in wholesale bond markets based in the UK. We agree with the view of the majority of respondents that a combination of competition, market-driven transparency, the interaction between cash and credit derivatives markets, and regulation seems sufficient, in general, to deliver efficient pricing and fair executions.'

3. 'Extreme caution would need to be exercised in mandating greater transparency in the UK and Europe. In particular, we agree with many respondents, and with the conclusions of the CEPR research, that mandating pre-trade transparency is likely to impact on the existing complex market structures, in potentially significant but unknown ways. We also note that these markets are still relatively dynamic, and continuing to evolve.'

The EU's bond markets are mainly traded through London, although issues emanate from all over the world and many bonds are also issued in Luxembourg in particular (but mainly traded in London). In the light of the FSA's findings and the research and responses on which it was based, the BBA would urge CESR to reach the same conclusion as the FSA – namely that there is no market failure in European bond markets.

Transparency in the bond and derivatives markets is growing all the time with the development of increased electronic trading and Straight Through Processing (STP). However inevitably, transparency is greater for the more liquid bonds / derivatives. For more illiquid instruments the practical issue will always be the small number of dealers who are willing to commit capital, and the fact that often there will only be one dealer who is prepared to make a market. This, however, is a perennial characteristic of the bond market – and not something that can be changed by greater transparency. In view of this, our members consider changes to the transparency regime are likely to be of marginal benefit and that there is a substantial risk that any utility would be outweighed by the risks and costs associated with potential changes.

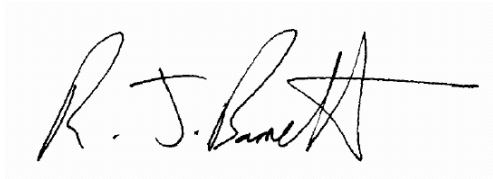
Transparency is evolving naturally from market driven initiatives such as STP and direct access to the market, the additional infrastructure and cost to the industry of mandated transparency requirements would not be balanced by a commensurate increase in investor knowledge or understanding. Our members are in favour of liquidity and transparency and would support a market driven solution to increasing transparency. Our members would not however support the ICMA proposals in their current format.

One of the more striking findings of the CEPR research is that spreads in the European Corporate Bond market are actually narrower than those in the US Corporate Bond market. Since the US bond markets already have many of the regulatory features which the EU has been leaning towards, this spread comparison demonstrates that increased transparency will not automatically lead to improved prices for the client.

The US EU comparison highlights another undesirable consequence of increased transparency and regulatory requirements in the bond markets which is its anti competitive nature. In the US, the market is for the most part dominated by a few very large institutions. In short increased regulatory burdens raise barriers to entry, drive out the smaller players, reduce competition and result in increased spreads.

Answers to CESR's questions set out in the consultation paper are in Annex I to this response. If you would like to discuss this response with us please contact Ross Barrett (ross.barrett@bba.org.uk , +44 207 216 8841).

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'R. J. Barrett', with a long horizontal stroke extending to the right.

Ross Barrett
Director
British Bankers Association

Annex I – Answers to Questions

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?

We consider that there is no convincing evidence of market failure in the bond and non-equities markets. As outlined in the cover letter we would refer CESR to the FSA's extensive study on the bond markets in the UK as the largest centre of bond market trading in Europe.

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

We do not consider that there is any evidence of substantive market failure in non-equities markets. CESR should consider that transparency is only one aspect of market functionality, there is not a direct linear relationship between the level of transparency and the extent of any market failure. Therefore even if CESR were to surmise that there were some form of significant market failure, (which we would not agree with) the application of greater transparency would not necessarily alleviate it.

The industry would be very strongly opposed to the introduction of any form of mandatory pre-trade transparency. It is inappropriate and would fundamentally change the nature and functioning of the bond markets in Europe. This is not the aim that MiFID is trying to achieve. This issue would apply equally to other non-equity instruments. CESR should consider the size, developing nature of many of these non-equity markets before considering the possibility of mandating any pre-trade transparency that runs against the grain of the market.

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

MiFID will implement very strong suitability and appropriateness obligations for intermediaries dealing with investors. This point is particularly apposite for interactions with the MiFID category of retail clients. It is from the suitability and appropriateness obligations that investors will draw additional protections rather than extensive transparency arrangements. The BBA fully supports strong protections for retail investors when they are investing in non-equities markets. This is the right way of dealing with this issue, rather than instituting wide ranging transparency proposals that would impact negatively on the wholesale bond market. CESR must consider that there is a global bond market and if regulation becomes too onerous, liquidity could and will leach away to other markets. CESR should also take into account that the wholesale bond market is many orders of magnitude greater than the retail bond market. This wholesale market is fundamentally funding corporate Europe and investment therein. A heavy regulatory drag on this market, would impact not just banks and financial intermediaries but the entire European corporate landscape. The wholesale bond market is also important for funding governments and related entities, not just corporates, so any detrimental effects on the market might raise borrowing costs for some state issuers too.

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?

We would urge CESR to consider the meaning of investor protection. There will always be instances where investors feel (rightly or wrongly) that they have not received appropriate protections. However CESR must consider how greater mandated transparency would have aided the investor in such a situation. Taking the bond market as an example, given the sheer number of bonds and the rate of flow of issuance of new bonds it has been estimated that if prices were printed in a newspaper at 8pt type it would take 10 pages of a broadsheet to cover them all. Even reproducing prices for 'commonly traded bonds', (although we would query how 'commonly traded' could be defined) would be a vast undertaking. It would have to be considered that these prices may in fact be misleading as often these bonds will not have traded at all on a day to day basis. In the event of some form of market shock, liquidity tends to disappear and investors will not be able to achieve the previous day's prices they see quoted in the newspaper. Even the possibility of a delayed prices website would be misleading, in that prices being posted would be mostly for very large or block trades with commensurate pricing.

The issue highlighted is that, given transparency is evolving naturally from market driven initiatives such as STP and direct access to the market, the additional infrastructure and cost to the industry would not be balanced by a commensurate increase in investor knowledge or understanding.

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?

CESR should consider the very many types of non-equity instruments that are available in the market and that applying mandatory transparency arrangements for certain types of derivatives would be unworkable.

We do not see how it would be possible to extend transparency to only certain types of investors. Transparency is only one part of the functionality of that makes up the market structure. However, any such proposal has to be considered very carefully as it may achieve little or no net benefit for the market as a whole, simply resulting in driving some activity either outside the EEA or into other forms of investment.

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?

We do not consider that there is any significant market failure. However, criteria for determining if self-regulatory solutions are adequate might include whether any industry solution would provide additional relevant and useful information to investors who would not otherwise have access to such information, without disproportionate effects on the relevant market or particular sectors of it, and without disproportionate direct and indirect costs for participants in that market.