



Deutsche Börse Group

Deutsche Börse's Response
to
CESR's
Public Consultation

Non-equity transparency

Frankfurt / Main, 8th June 2007

Executive Summary

Deutsche Börse Group welcomes the opportunity to respond to CESR's public consultation on non-equity transparency. We highly appreciate efforts undertaken by CESR in the discussion to account for particularities of the bond markets while contemporaneously accommodating for retail investors' demand for increased transparency.

Deutsche Börse Group with its Eurex markets for bonds and FWB already delivers a high degree of transparency even outside the Community to the interested market participants and the public. We view transparent markets as a catalyst for truly harmonised and integrated Single Market in Europe.

In general, the consultation paper at hand provides a good overview of the discussion surrounding transparency requirements in bond markets in particular and the prevailing concerns in immediate and one-for-one extension of MiFID-like transparency provisions for shares admitted to trading on a regulated market to bonds as well. Currently, we deem a better approach conducting a sound cost-benefit analysis of:

- The impact of the current MiFID transparency provisions for shares admitted to trading on a regulated market, and
- The implications of an extension thereof (alike or modified) to bond markets,

instead of discussing the potential existence of a market failure as a justification for mandatory transparency. If CESR chooses to proceed with the market failure approach, then we do not see why bond markets should be dealt with differently from equity markets.

We recommend CESR to consider the following issues when interpreting the responses to this consultation and deciding next steps:

- An EU-wide harmonisation of post-trade transparency would be most welcome and helpful in assessing best execution in bond transactions.
- With respect to pre-trade transparency we recommend to apply a light-touch approach in order not to harm the wholesale bond market but to account for possible segmentation of transparency requirements and meet the demand for more transparency expressed by retail market participants.
- Transparency could be defined and split up in different levels. In order to avoid potential downside for liquidity, transparency levels should focus on pre-trade information like best bid and ask prices incl. quote or order size and post trade information with historic prices and traded volumes. MiFID-criteria prudently accommodating for differences in market practices related to types of systems, transaction and liquidity aspects valid for equity markets could be used to define

similar criteria applicable to bond markets, while contemporaneously taking into account particularities of the bond market.

- We ask CESR to be more consistent and sufficiently distinguish at the stages where necessary between pre- and post-trade transparency (e.g. withdrawal of liquidity is possible at the most in the case of pre-trade transparency and in less liquid bonds).
- There is no doubt that differences exist between equity and bond markets and this has been sufficiently elaborated on during previous consultations. But we view market failure as not being the right motivation for the analysis of non-equity transparency, as it is inconsistent with the approach used for equities.

Please find below our detailed remarks and responses.

Detailed Remarks

Question 1 (page 9):

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

We generally agree with CESR's analysis of how to assess the existence of a market failure in bond markets.

Analyzing the existence of a market failure in the first instance constitutes one possible approach to identify necessity for regulatory intervention. However, although we know that the European Commission posed the specific question regarding the existence of a market failure in the secondary bond markets in Europe, we would appreciate if CESR would focus more on a sound cost-benefit analysis rather than focusing on whether there is a market failure in the secondary bond market. Recalling the discussion around the adoption of pre- and post-trade transparency provisions for shares admitted to trading on a regulated market, we cannot remember any discussions about a possible market failure in equity markets which then would have justified a mandatory pre- and post-trade transparency. One argument for justifying this approach might be the existence of structural differences between equity and bond markets as already outlined by CESR in this consultation paper. But from a market perspective we deem it more comprehensive not to assess potential mandatory extension of MiFID-transparency provisions against assessment of potential market failure in a mainly wholesale bond market which is functioning well, but rather to provide quantitative and qualitative facts of costs and benefits of increased pre- and post-trade transparency in secondary bond markets.

The discussion around increased transparency in bond markets comes at a stage when it cannot be evaluated how the current MiFID transparency provisions for shares coming into force on 1st November this year impact the market. A cost-benefit analysis for the current MiFID transparency provisions would be of tremendous value in assessing next steps in terms of potentially copying these requirements to bond markets as well.

If however CESR sticks to the assessment of market failure approach, a clear distinction between retail and wholesale segment must be drawn in order to account for special characteristics of the bond market and provide a tailored solution. In this case, we agree with CESR that it might be difficult for retail market participants to access information and successfully incorporate them into the investment decision.

Question 2 (page 11):

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

We agree with CESR's view that an increased participation of the retail buy-side might be encouraged via increased transparency. As CESR correctly states, the associated cost-benefit analysis would differ depending on pre- or post-trade transparency requirements. However, we would encourage CESR to draw a clear distinction between pre- and post-trade transparency and to be more precise on the implications thereof. For example, adverse effects for market makers' willingness to provide liquidity can occur at the most from mandatory pre-trade transparency requirements.

Question 3 (page 14):

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

We believe that increased post-trade transparency in markets where retail investor participation is pronounced would be helpful. This could be designed in diverse ways, e.g. provision of trading data close to real-time or end-of-day, up to specific trade or ticket size, in general in a way similar to what has been accounted for in terms of liquidity, types of systems and trade sizes applied under MiFID for shares (see our response to the next question). With respect to pre-trade transparency, it might be challenged what added value retail participants would have if these information would be given at hand. In every respect, any consideration of pre-trade transparency motivated by retail investor protection must account for particularities of retail and wholesale bond markets. Please see our response to the next question.

Question 4 (page 14):

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?

On the one hand, if the outcome of MiFID's best execution requirements will be not only compliance with the best execution policy, but real delivery of best possible result for the client, it is likely that transparency will be improved by the best execution obligation. Banks quite often offer retail clients interested in bond positions to execute against nostro account on a net basis rather than executing the order via an exchange. This net price is difficult to be evaluated by the retail investor against the gross (quite often even unknown) exchange

price plus commissions. In the course of MiFID's best execution requirements to take into account all fees and commissions charged to the client for the specific order, the client will be offered full commission transparency enabling him to compare trades executed OTC and via exchanges and the associated execution costs. In this way, competitive pressure on the intermediaries will come from the buy-side, when investors assess ex post how their orders have been executed. This effect would be amplified by increased financial literacy of retail clients. Hence, it is indeed likely that the implementation of MiFID might enforce voluntary transparency on the sell-side.

On the other hand, providing best execution in bond markets might be difficult to deliver even after entry into force of MiFID. In contrast to equity markets where trades are executed on regulated markets which are legally obliged to provide pre- and post-trade transparency, trading of bonds is highly fragmented between regulated markets, multilateral trading facilities and bilateral trading. The reasons leading to a Europe-wide introduction of post-trade transparency in equity markets should therefore at least be valid to the same degree for bond markets as well. Those were mainly based on improvement of market efficiency and facilitation of price discovery, both achievable through quicker information processing and establishment of a level playing field. When analyzing how pre- and post-trade transparency provisions of MiFID for shares admitted to trading on a regulated market have been designed, it becomes obvious that those accommodate for various distinguishing criteria:

- type of system (Annex II, Table 1 of the Implementing Regulation)
- transaction size (Annex II, Table 2 and 3 Implementing Regulation)
- liquidity aspects (Annex II, Table 4 Implementing Regulation)

But during the discussion conducted in this public consultation and consultations before, it is precisely these criteria which are taken as justification for proposing differing requirements for transparency in bond markets. Therefore, we would kindly ask CESR to explain why criteria prudently accommodating for differences in market practices related to types of systems, transaction and liquidity aspects valid for equity markets do not apply for bond markets.

Question 5 (page 14):

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

Improving retail investor education should be subject to the voluntary educational efforts on the part of the investors themselves on the one hand, and a part of competitive differentiation of the sell-side on the other hand. Leaving investor education to competitive forces of the market would give the sell-side an additional marketing instrument, enabling the institutions to distinguish themselves from others via demonstrating investor-friendliness.

Not least, such an investor-oriented approach is in the interest of the sell-side, as it implies increased investor confidence and a higher provision of funds by the buy-side.

One of the announced initiatives of ICMA to develop and maintain a retail investor website intended to provide information and educational material about investing into bonds is therefore welcome and possibly constitutes a trend in the area of investor education.

Question 6 (page 16):

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 with CESR's conclusions. However, circumstances cannot be ruled out that the wholesale market participants more expeditiously gain access to information about e.g. an upcoming and likely default than these information are shared to the public. Searching for ways to prevent that such informational advantage becomes detrimental to other / retail market participants is probably one of major challenges of establishing a tailor-made transparency in bond markets.

Question 7 (page 18):

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

We agree with CESR's assessment of possible segmentation of transparency. We deem it equivalent to the transparency systematics applied to shares admitted to trading on a regulated market under MiFID, but amended by an additional factor of differentiation between retail and wholesale bond market. Going one step further and harmonising post-trade transparency level provided across European bond markets by segments might further encourage cross-border bond trading.

Question 8 (page 21):

Dou you agree that we 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.

Current self-regulatory initiatives¹ are not led by the motivation of the MiFID scope and focus on transparency by means of prospects rather than on price and trading transparency. We therefore explicitly welcome the initiative undertaken by ICMA on a code of best practice with the aim of increasing post-trade transparency. Announcements of efforts to develop standards in post-trade transparency arena are highly appreciated and should be monitored by CESR against the goal to deliver harmonised and effective information to the bond market participants if a self-regulatory approach is chosen as more appropriate to serve market's demand for transparency.

¹ E.g. The Bondholders' Dialogue for the segment of corporate bonds.