February 2009

Thomson Reuters response to CESR consultation 'Transparency of corporate bond, structure finance product and credit derivatives markets' (CESR/O8-1014)

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Our financial data is updated on average 60,000 times per second and, at peak times, more than 200,000 times per second. We supply information from over 160 exchanges and OTC markets globally and maintain over 12 million data records. We are also the largest provider of risk management software in the world, supplying trade and risk management solutions to over 750 financial institutions globally.

<u>Concept of 'transparency'</u>

The notion of transparency has been at the forefront of regulatory debates surrounding the financial crisis and is discussed throughout the CESR Consultation Paper. At the outset, we believe it is important to clarify how this term should be understood, particularly in relation to the structured finance and derivatives arenas. These different definitions should be clearly differentiated, as they have varying impacts on the workflow and the participants:

1. **Trade Execution Transparency:** it is crucial to note that there will and should be differences between odd-lot (retail) pieces and round-lot (typically institutional) pieces for all non-equity transactions.

2. **Information Transparency**: this has been one of the key factors leading to today's credit environment. The lack of readily available underlying information and surveillance information with regards to structured finance has placed considerable burdens in the marketplace. To be clear, this includes not only public but also private deal structures.

3. **Model Transparency**: this issue can be broken out into two parts:

    - Rating Agency Models – this is with regards to models that the rating agencies utilise to create ratings.

    - Valuation Models – this is with regards to cash flow models utilised in creating evaluations on a mark to model basis.

TR responses to individual questions

1. *Do you believe the situation described above may be symptomatic of a market failure?*

We do believe that the situation described in the scenario is symptomatic of market failure. Liquidity has contracted greatly due to a number of different issues; however a contraction in liquidity would lead to market failure not the other way around.

2. *Have you perceived a potential asymmetry of information between market participants?*

There is potential asymmetry of information between market participants, however this is endemic of OTC markets that lack post-trade reporting requirements. This was true of the US corporate bond market before TRACE and similar in the US municipal markets prior to the MSRB reporting requirements.

3. *In your view, what were the key reasons which have led to sharply reduced liquidity in secondary trading of European corporate bonds since 2007?*

In our view, the sharp decrease in liquidity in almost all markets since 2007 has been the retrenchment of the asset managers across asset classes. This is largely due to two issues: the first is the huge outflows that have occurred in this market; the second is the lack of confidence in credit.

4. *Do you believe that additional post-trade transparency of European corporate bonds would have helped maintain liquidity in stressed market conditions? Can you please explain why?*

Additional post-trade transparency in the European corporate bond market may have helped liquidity, but only marginally. While the price discovery would have assisted in some cases, the lack of bid would have shown a thin market regardless.

5. *In your view, what were the key reasons for the widening of the bid/offer spreads for European corporate bonds?*

The widening of the bid/offer spread, again, was due to the general lack of liquidity and the reasons for this are outlined in answer to question 3 (above).

6. *Do you believe that greater post-trade transparency would have been helpful in limiting the widening of the bid/offer spreads we have observed for European corporate bonds?*

Liquidity and bid/offer spreads have almost always been congruous.

7. *Do you use CDS prices for pricing European corporate cash bonds? If so, what are the key benefits?*

As an evaluator, we utilise the changes in CDS levels to trigger greater surveillance, but not as a benchmark for our evaluated services.

8. *Which methods of bond price valuation do you use in the current market turmoil? Do you think that the CDS market is still a reliable indicator for bond price valuation?*

We use the same methodology including dealer quotes, executed traded prices and the new issue markets.

9. *The spreads between the CDS and corporate cash bonds have widened significantly in the first quarter of 2008. Did this widening of the spreads make it more difficult to price European corporate bonds? If so, do you think that additional post-trade transparency of corporate bond prices would have helped you to price European corporate bonds? How do you assess the situation since mid-September 2008?*

The widening of the spreads were triggers for our evaluators, however they did not increase the difficulty in pricing – the difficulty lay in the lack of market information. Yes, additional post-trade transparency would have benefited our evaluators greatly. The situation has levelled off since September 2008.

10. *Do you expect that the relationship between the CDS market and the cash bonds market will return to what has been observed historically once market conditions stabilise? If not, can you please articulate the reasons?*

While the relationship between CDS and cash bonds may return to what was observed historically, there are three detriments to relying on the CDS markets:

1. With between $50 Trillion and $65 Trillion outstanding, this is an overpopulated trade and could lead to systemic counterparty risk unobserved in the history of the markets.

2. The ratio of CDS to cash at 30:1 or 40:1 is could potentially have massive adverse effects on the markets.

3. As with the price of oil fluctuations in the last year, the rise in CDS as a tool for speculation doesn't necessarily create true value or act as an indicator for the cash markets.

11. *Have you experienced difficulties in valuing corporate bond holdings? If so, what were the main reasons?*

There have been increased difficulties in valuing corporate bonds, however, this just requires more work as valuation is a staple service of Thomson Reuters.

12. *Would additional post-trade trade transparency in distressed market conditions help valuation?*

Yes, additional post-trade transparency would help valuations in distressed markets.

13. *Do you agree with the potential benefits and drawbacks described above? Please provide evidence supporting your opinion. Please explain how the potential drawbacks might be mitigated.*

Yes, we agree with the potential benefits and drawbacks listed. While required transparency tools, such as the TRACE system, could impair liquidity in the short run, the markets have always shunned innovation that could tighten spreads. However, as the playing field is levelled, and if this were regulated, the markets would adapt as in the US. As noted in Section 4, liquidity has increased, however this may or may not be related to TRACE, and could rather have been related to the ease of credit and leverage post TRACE implementation.

14. *Are there other main benefits or drawbacks of increased post-trade transparency in the bond markets which CESR needs to consider?*

While we feel that CESR has touched on the poignant issues with regards to post-trade transparency, it is important to note the discrepancies of odd-lot and round-lot trading.

15. *What are your personal experiences with TRACE? Please specify whether you are directly trading in the US corporate bond markets on the buy or sell side.*

Thomson Reuters' strength is that the organisation does not execute trades in either the primary or secondary market. This allows for complete independence and lack of conflict of interest in our services.

16. *Do you see other benefits or drawbacks of the introduction of a TRACE-like post-trade transparency regime for OTC trades in corporate bonds in Europe?*

The drawback of the introduction of a separate TRACE like system in Europe is that the markets today are truly global and the market participants are increasingly looking at multi-regional trades. A globally-linked system would make the most sense.

17. *Are you of the view that the more notable volume declines experienced for 144a securities, compared to securities which are covered by TRACE, is due to a lack of post-trade information? Please provide a rationale.*

The 144a volume declines are symptomatic of lack of readily available terms and conditions, not the lack availability of post-trade information. Thomson Reuters buy side clients have expressed interest in buying in today's marketplace, however, they lack underlying 144a data for their risk profiles or rich/cheap analysis.

18. *Please provide information on your experience, if any, in terms of timing, content and access to information of the market-led solutions outlined above. What is your assessment of the effectiveness of the present self-regulatory initiatives?*

Existing self-regulatory initiatives tend to be slow to adapt. As a data aggregator and vendor, it is key that data be made available to all data vendors simultaneously to ensure a level playing field. This would include embargos if necessary.

19. *Please provide comments on the characteristics that market-led initiatives should, in your view, have.*

In our view, market led initiatives must have greater transparency and Thomson Reuters agrees with the CESR view that content and timing provided to the public should be enhanced.

20. *Do you think that the introduction of additional post-trade information on prices could help restore market confidence and maintain market liquidity in times of future crisis?*

Thomson Reuters agrees with the CESR view that additional post-trade transparency will not help restore market confidence as this issue is much broader.

21. *Do you believe that additional post-trade transparency of European corporate bond markets would contribute to liquidity in normal market conditions? Can you please explain why?*

Additional liquidity in the European corporate bond market may contribute nominally to liquidity as transparency becomes commoditised; however, if this is the case the increase would be marginal.

22. *To what extent can corporate bond markets be characterised as wholesale or retail markets? How would you distinguish between wholesale and retail markets? What are the differences across the EU?*

The differences between the wholesale and retail markets lie mainly in odd-lot or round-lot trades. These differences will be characterised in the bid/offer spread. Market making institutions should not be penalised for offering odd-lot trades. If there is no ability to mark these trades differently, it could have an adverse effect on the retail market.

23. *What would be the benefits and the downsides of a harmonised pan-European transparency regime for: a) the wholesale market; b) the retail market. Please provide arguments and fact-based data on the potential impact.*

The benefits of harmonised pan-European transparency would be that investors (both retail and institutional) would be able more easily to compare cross-border issues. The downsides would be the implementation-related costs.

24. *Is the reduced reliability of the CDS market as an indicator/proxy for calculating the value/price in the cash market under certain market conditions an issue which calls for more post-trade transparency of cash corporate bonds?*

The reduced CDS information for calculating valuations is not an issue that calls for more post-trade transparency. As a core business of Thomson Reuters, this is a staple of our workflow already, was so prior to the advent of CDS and will continue to be so regardless of the changes in the CDS markets. Also as noted above, the CDS fluctuations only serve as triggers since the leverage effect and ratios of this market can be misleading.

25. Do you think that transparency requirements could help address wider issues such as those relating to accurate valuations?

Transparency requirements would indeed help in creating greater accuracy for valuations. The better and more timely the information, the better the ability for an evaluator to do their jobs most effectively.

26. *What would be the most cost-effective way of delivering additional transparency an industry-led solution, possibly based on a road map set by regulators, or mandatory regulatory post-trade transparency requirements? a) the retail market b) the wholesale market; Please, provide a rationale.*

Solutions are already available in the market. Transparency can be enhanced by utilising an existing data vendor with access to the sell side and buy side institutions, such as Thomson Reuters, which has an existing network of both desktop and enterprise solutions.

27. Which should be in your view the key components of a post-trade transparency framework for corporate bonds? Please provide your view with respect to depth and breadth of information as well as to timeliness of data as described above.

The components of the post-trade framework should include:

a) Identifier such as CUSIP, ISIN or SEDOL
b) Standardized format for identification
    a. Ticker
    b. Coupon
    c. Maturity
c) Size of the transaction (par amount)
d) Currency
e) Price and Yield
f) Trade time
g) Trade date
h) Settlement date

As with the TRACE system, the transactions should be reported within one hour of the trade. These transactions should be segregated by region and currency.

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1. *Should the information on the volume be reported only below a certain size, what would be the threshold to avoid any risk of market impact?*

As opposed to only reporting under a certain par amount, the trades should be flagged and can potentially be disseminated under two different reporting umbrellas in the same system.

29. *Would you see some benefits in a step-by-step implementation, starting with the most liquid bonds, as employed when TRACE has been introduced?*

As a champion of better transparency, Thomson Reuters would be interested in taking on all markets, liquid and illiquid simultaneously, as we already have the underlying data on the European securities in our database.

30. *Does this analysis represent your practical experience regarding information relevant and available for pricing of each of the products covered by this consultation paper?*

The chart below represents the updated Thomson Reuters offerings.

Thomson Reuters	Data Vendor	Contributed, Composite, Evaluated	Real Time, End of Day	Service launched 1/1/2009 – 3000 investment grade tranches, lower grade at customer request

While the dealer pricing may be stale, Thomson Reuters utilised various techniques including providing curves for different asset classes. These curves serve as a matrix to create evaluations based on a number of different attributes. A multitude of prices are available on the Thomson Reuters Desktops.

31. *Are there other sources of information available which you use for pricing and valuation purposes? Can you provide details regarding the respective role of pricing services using proprietary models and consensus pricing services?*

This question is not applicable to Thomson Reuters.

32. *What do you think are the benefits and/or downsides of a post-trade transparency regime for ABS? Please support your arguments with evidence and explain how the possible downsides could be mitigated.*

As the markets have entered into uncharted territory, it is important to seek multiple solutions that to try to revive liquidity. While Thomson Reuters agrees with the CESR assessment that transparency in pricing would not have mitigated the current market conditions, there is a need for better information in the structured finance markets. As we are, hopefully, at the nadir of the market, there is no downside from here. Other benefits include dated trades as some of the issues are thinly traded. Dealer identity should be withheld in order to avoid reduction in willingness to deal.

33. *Do you believe that post-trade transparency would be desirable for all types of ABS? If not, can you explain which types of instruments/tranches (eg. AAA RMBS) should be subject to post-trade transparency?*

No instruments should be excluded as this may lead to arbitraging regulation. Having transparency limited to certain instruments could potentially lead institutions to shy away from those instruments assuming a two-tiered system.

34. *Would it be meaningful to segment a post-trade transparency regime between 'higher liquidity' ABS (ie. commoditised products, standardised structures, higher credit quality and homogeneous collateral) from 'low liquidity' ABS (i.e. bespoke products, non-standardised structures, lower credit quality, heterogeneous collateral)? In this case, could you explain what could be considered as low liquidity ABS?*

While segmentation between issues would help to distinguish the sub-asset classes, no segmentation should be made with regards to the liquidity of an issue.

35. *What post-trade information should be published? In addition to information about the price at which the transaction was executed, the volume and the time of the transaction, would there be any benefit in publishing information about portfolio composition, asset class, the initial interest (seller or buyer)? Is there any other information which would be relevant?*

We suggest that the same information fields should be used as in our response to question 27. Note that it is crucial to differentiate a forward dated settlement trade as this would affect the price and may skew the issue.

36. *When should post-trade information be published? Should it be published immediately after a trade has been concluded? Please explain rationale.*

As with TRACE there should be timeliness in reporting the trade, however there should be an embargo from trade time with regards to dissemination so as not to favour any single aggregator or vendor.

37. *Do you believe that a post-trade transparency regime should or could be implemented in connection with other regulatory interventions at the same time (e.g. relating to the quality of information of the underlying assets, standardisation of reporting)?*

We believe that the programs initiated by SIFMA and the ESF should be the benchmarks for the industry.

38. *Would you like to make any other observations relevant for CESR work on the need for post-trade transparency for ABS?*

Thomson Reuters has no further observations.

39. *Please indicate whether you represent an organisation which is involved in: a) originating ABS b) selling ABS c) buying ABS d) providing pricing information on ABS; or e) rating ABS.*

Thomson Reuters does not originate, sell, trade or invest in ABS, but does provide pricing information.

40. *What do you think are the benefits and/or downsides of a post-trade transparency regime for CDOs? Please support your arguments with evidence and explain how the possible downsides could be mitigated.*

See our response to question 32 above.

41. *Do you believe that post-trade transparency would be desirable for all types of CDOs? If not, can you explain which types of structures/tranches (e.g. cash CDOs vs. synthetic CDOs) should be subject to post-trade transparency?*

No instruments should be excluded as this may lead to arbitraging regulation. Having transparency limited to certain instruments could potentially lead institutions to shy away from those instruments, assuming a two-tiered system.

42. *Would it be meaningful to segment a post-trade transparency regime between 'vanilla' CDOs (i.e. comparable to the ABS with standardised structures, higher credit quality and homogeneous collateral) from Structured Finance CDOs (i.e. bespoke products, non-standardised structures, lower credit quality, heterogeneous collateral)? In this case, could you explain what could be considered as less 'vanilla' CDOs?*

See our response to questions 34 above.

43. *To what extent would post-trade transparency be helpful to reduce the bid and ask spread or price dispersion for a particular transaction/instrument?*

CDOs are highly illiquid in the current environment, so there can only be improvement.

44. *What post-trade information should be published? In addition to information about the price at which the transaction was executed, the volume and the time of the transaction, would there be any benefit in reporting information about portfolio composition, asset class, the initial interest (seller or buyer)? Is there any other information which would be relevant?*

We suggest that the same information fields should be used as in our response to question 27.

45. *When should post-trade information be published? Should it be published immediately after a trade has been concluded? Please explain rationale.*

As with TRACE there should be timeliness in reporting the trade, however there should be an embargo from trade time with regards to dissemination so as not to favor any single aggregator or vendor.

46. *When facing inactive markets, to what extent would a post-trade information regime be applicable? If not, could you detail the rationale for an alternative system when markets are no longer active?*

As mentioned above, since the markets are at their nadir in CDO issuance and trading, any and all information is better than none.

47. *To what extent can observable prices in the secondary market help to test or promote internal valuation models?*

Thomson Reuters believes that internal models should be used for analysis, but not for pricing and evaluations. Independent institutions, such as Thomson Reuters, should be responsible for valuations as such institutions have no stake in the assets.

48. *Do you believe that a post-trade transparency regime should or could be implemented in connection with other regulatory interventions at the same time (e.g. relating to the quality of information of the underlying assets, standardisation of reporting)?*

Yes, as per transparency definitions provided above, all of these issues have impacted the existing markets.

49. *Would you like to make any other observations relevant for CESR work on the need for post-trade transparency for CDOs?*

Utilising a vendor that standardises data is key to implementing these transparency recommendations. A vendor, like Thomson Reuters, with breadth of market penetration, and the ability to normalise data from legacy systems would be useful in implementing industry transparency.

50. *Please indicate whether you represent an organisation which is involved in: a) originating CDOs b) selling CDOs c) buying CDOs d) providing pricing information on CDOs; or e) rating CDOs.*

Thomson Reuters does not originate, sell, trade or invest in CDOs, but does provide pricing information.

With regard to the remaining questions (51. to 61.), our views largely recapitulate the areas and themes discussed above.

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