af2i
association française
des investisseurs
institutionnels

Mr Carlo Comporti
Secretary General
Committee of European Securities Regulators (CESR)
11-13, Avenue de Friedland
75008 Paris

Paris, 2 March 2009

AF2I RESPONSE TO CESR'S CONSULTATION PAPER ON THE TRANSPARENCY OF CORPORATE BONDS, STRUCTURED FINANCE PRODUCTS AND CREDIT DERIVATIVES MARKETS

Dear Mr Comporti,

The Association Française des Investisseurs Institutionnels (AF2I)[1] welcomes CESR's consultation on the transparency of corporate bond, structured finance products and credit derivative markets.

In relation with the AFG's response, which we fully support, our present paper is related to stress out the following points.

- The present illiquidity conditions both on the derivatives markets and more on the corporate bonds markets represents a major threat for Institutional Investors as they have to follow specific rules both in terms of asset allocation and asset representation;

- The fact that banks are retreating from brokerage or market makers activities on the Corporate bonds market adds very much uncertainties in the pricing output and in conditions upon which operations will be settle,

- The enormous spreads widening we assist presently adds considerably to the confusion as prices can't be fixed only for very short term periods of time (from a few minutes to half an hour at the max), therefore putting pressures on the investment decisions and increasing the risk of mismanagement.

[1] The Association Française des Investisseurs Institutionnels (Af2i) represents the France-based institutional investors (insurance companies, pension funds, mandatory pension schemes...). It is an association of asset owners and has for vocation to federate all the economic actors concerned by the procedures and the techniques of institutional management. It currently includes 74 members, managing assets for a global amount of 1000 billion euros, that is to say more than 50% of the long term institutional savings in France.

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Therefore, in response to your consultation paper, we would presently add to the AFG report the following observations

PART I: CORPORATE BONDS

Q1 and Q2: was there a market failure? Was there a potential assymetry of information between market participants?

- Idem AFG report

*Q3 and Q4: **Market liquidity**: which reasons for the reduction of liquidity in secondary trading of European corporate bonds since 2007? Would additional post-trade transparency have helped keeping liquidity?*

- Idem AFG report

*Q5 and Q6: **Bid/offer spread**: why has it widened? Would additional post-trade transparency have helped limiting the widening?*

- Idem AFG report.

The widening of the Bid/offer spread is from our side clearly linked with the fact that banks, despite of staying as major actors of the primary Corporate bonds market, deserted the secondary bonds market; in this respect, banks are not and cannot be fully replaced by independent brokers.

Therefore in order to reactive the secondary market a systematic reporting of prices effectively dealt on the market should to be built up first by the financial community.

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*Q7 to Q10: **CDS/corporate bonds relationship**: are CDS prices used for pricing European corporate cash bonds? Which bond price valuation methods are used in the current turmoil? Is still the CDS market a reliable indicator for bond price valuation? Has the widening of the spread between CDS and corporate cash bonds made it more difficult to price European corporate bonds? Would additional post-trade transparency of corporate bond prices have helped pricing the European corporate bonds? Will the relationship between CDS and cash bonds come back to the previous situation later on?*

The AFG report underlined that the present difficulty of refinancing positions is nowadays linked with : "the very significant negative basis on the corporate market between the cash and the CDS for the same corporate and the same maturity".

We fully support this position and would ask the Commission to explore more this aspect, as the introduction of the CDS has been a great source of concern for bonds traders since their introduction, this kind of protection responding more to securitization schemes than to bonds valuation formulas.
Bad correlation between CDS and bonds of a same issuer nowadays contributes to deteriorate even more liquidity and valuation quality on bonds markets.

*Q11 and Q12: **Valuation**: which difficulties for valuating corporate bond holdings? Would additional post-trade transparency in distressed market conditions help valuation?*

- Idem AFG report.

*Q13 and 14: **Benefits and drawbacks of increased post-trade transparency**: Which ones (e.g. better access to information, reduction of transaction costs, provision of liquidity, best execution, investor protection, corporate bond valuation, quality of bond indices)?*

Several French financial codes, that apply to different kinds of institutional investors, make reference to the obligation to invest in representative assets on organised markets, working with regularity.

The present markets conditions are near a breach of such a legal condition, with market disruption in the information dragging price deformations with significant disconnections between last traded or quoted prices from "market" prices.

On this point and to recoup not only with better market conditions but with the market legacy we strongly underline that the solution, as noted in the AFG report, ***should be*** "to make pressure on index providers to require them to use the same marketplace referential, built on really dealt prices fuelled by several contributors".

On this matter AF2i points out that precise information in relation to OTC transactions should be released to the marketplace in nearly real time, in order to facilitate market transparency.

*Q15 to 17: **the US TRACE experience**: which personal experience of it in trading US corporate bond markets? Which benefits to introduce a TRACE-like post-trade transparency regime for OTC trades in corporate bonds in Europe? Is the decline of securities not covered by TRACE (i.e. 144a securities) due to the lack of post-trade information?*

Idem with AFG report observations about the relevance of TRACE.

*Q18 and 19: **Market-led initiatives in the trade transparency area: ICMA and SIFMA**: was it efficient? Which characteristics the market-led initiatives should have?*

*Q20 to 29: **Conclusions and recommendations**: would additional post-trade information on prices restore market confidence and maintain market liquidity? Can corporate bond markets be characterised as wholesale market or retail markets; are there differences across the EU? Which benefits and drawbacks for a harmonised pan-European transparency regime for the wholesale market and the retail market? Should we call for more post-trade transparency of cash corporate bonds, given the reduced reliability of CDS market as a proxy? Could transparency requirements help getting accurate valuations? For delivering additional transparency, should we favour an industry-led solution based on a road map delivered by regulators, or mandatory regulatory post-trade transparency requirements – for the retail market and/or the wholesale market? Which key components for post-trade transparency (depth and breadth of information, timeliness of data, etc.)? How to avoid a market impact of information on the volume? Could we envisage a step-by-step implementation, starting with the most liquid bonds (e.g. TRACE progressive introduction)?*

We clearly stressed that having normal liquidity conditions is a clear condition for pension funds, funds managers and investors for being able to arbitrage their assets at markets conditions reflecting real prices and effective spreads.

As institutional investors, we have a very strong allocation in bonds on the euro market. Therefore, we strongly believe that European authorities have to push ahead for the organisation of a European multilateral trade system (MTS) in which all transactions on euro denominated bonds would be reported. Issues concerned by such an implementation would be a matter to debate with the marketplace, but it seems to us that priority should be given to large size banks and corporate investment grade euro-issues, and lowering the size progressively, once the system is working.

This system could work being part of a compensation process or exert from it.

Meanwhile, banks and main corporate issuers should probably work on the necessary standardization process of their bonds issuances.

PART II: STRUCTURED FINANCE PRODUCTS AND CREDIT DERIVATIVES

No other observation as of the AFG report.

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