

Madrid, February 6th, 2007

Introduction

Bolsas y Mercados Españoles (BME) is the company that integrates all the securities markets and financial systems in Spain. The parent group comprises the Madrid, Barcelona, Bilbao and Valencia stock exchanges, MF Mercados Financieros, Iberclear and BME Consulting. BME is one of the leading European market operators.

BME welcomes CESR/07-108 Call for Evidence on “Non-equities markets transparency” and thanks the opportunity to submit its views in relation with the six questions set down in the document.

Answers to the 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?

Overall, the lack of high transparency standards in fixed-income markets results in the following inefficiencies:

- o *Disparity in the ask/bid prices for fixed income assets*

In general, in the European fixed income markets, voluntary transparency have always resulted in information asymmetries. Due to such asymmetries between market participants, insofar as they do not have the same market information, nor equal access to such information, which is not received at the same time either, price differences occur, in practice, in transactions on the same fixed-income asset.

- o *Low degree of retail investment in fixed income asset*

As a consequence of the lack of a common playing field in terms of market information among different investor types, an additional inefficiency arises in the fixed income market: the degree of retail investor participation in this market is not relevant, even existing fixed-income products that might be addressed to such kind of investors, compared to the levels these investors have in equity products, where their participation benefits market depth, activity ratios, correct asset valuation and, in general, the role the markets must play in their respective economies.

- o *Lack of global statistics on fixed-income markets*

The lack of general information is proven by the inexistence of databases and global statistics on a European level concerning turnover and prices. Nevertheless, in our experience, markets such as the Spanish fixed income market (both public and corporate debt) in which there is a continuous supervision of transactions on fixed income products, help mitigate the information deficit these instruments undergo.

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

The best empirical evidence on the effects of transparency on bond markets can be obtained from studies made on the US market, as the introduction of the Trade Reporting and Compliance Engine (TRACE) by NASD in July 2002 provides for a unique testing ground with real market data.

The conclusions of such studies demonstrate the following benefits of increased transparency in bond markets:

1. Increased transparency results in a reduction in trading costs in a range between 20- 50% depending on the study and the size of the sampled trades¹
2. Greater transparency increases liquidity in bond markets (measured both by trading volume and bid ask spread) as a result of the abovementioned lower transaction cost and reduction of information asymmetries, thus benefiting less sophisticated investors.²
3. Increased transparency results in intensified competition among dealers and a boost to market innovation (as shown by the appearance of new fixed income products and structures linked to transparency measures)³
4. Increased transparency benefits are far from being a zero sum game. It is true that such benefits are of greater use to liquid bonds but not at the expense of illiquid ones since they also, albeit to a lesser extent, profit from it⁴.

We have to take into account that TRACE is just a mechanism of transaction reporting that disseminates information to the wider market with 45 minutes delay. Some of the studies mentioned suggest increasing benefits should a shorter delay be imposed or pre transparency obligations introduced.

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

In our view, MiFID will only change this picture to the extent that the best execution principle becomes effective.

We hardly see how the MiFID best execution provisions could be met in the absence of a comprehensive transparency obligations regime for bonds:

- a) The lack of pre-trade transparency will impair a price-based decision on where to send a bond order.
- b) The lack of post-trade transparency would make the selection of trading venues and the revision of its best execution performance impossible.

¹ Edwards, Nimalendran and Piwowar (2006); Edwards, Nimalendran and Piwowar (2005); Bessembinder, Maxwell and Ventarataman (2005)

² Goldstein, Hotchkiss and Sirri (2006)

³ Edwards, Nimalendran and Piwowar (2005); Laganá, Perina, Köppen-Mertes and Persaud (2006)

⁴ Edwards, Nimalendran and Piwowar (2005)

In short, investment firms would find it difficult to include price among its best execution factors when designing its best execution policy for bonds. It is worth emphasizing that, according to MiFID, price is a factor that must be considered in any execution policy and, even more, price is compulsorily the main criterion for best execution policies designed for retail investors.

It is sometimes argued that the transaction reporting regime established in MiFID will introduce some degree of transparency in the market and will alleviate some of the aforementioned problems, but this assumption misses the point of the real scope of the transaction reporting regime. It must be noted that MiFID reports on transactions are not disseminated to the market but sent exclusively to the competent authorities. Furthermore, they have nothing to do with immediate transparency as they may be reported up to the close of the following working day in which the transaction took place.

In more general terms, it must also be stated that MiFID aims to guarantee competition between trading venues, a level playing field, efficient price discovery, investor protection etc. To this end it provides for, inter alia, different types of trading venues (RMs, MTFs and Sis), conduct of business rules and transparency obligations. All this could imply a profound transformation of the current structure of the European equity markets which does not seem to be a problem given the potential benefits. However, when it comes to fixed income markets, its particular current structure is argued as an insurmountable obstacle to the extension of transparency obligations, as though such structure was taken for given.

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?

Whilst in the case of institutional investors it is difficult to detect cases in which investor protection is jeopardised by a lack of transparency, among retail investors the lack of adequate transparency levels leads to operational inefficiencies and distortions in the pricing of fixed income products, which diminishes the activity volume of this type of investors in these markets.

In the case of the Spanish jurisdiction, it is the market supervisor (CNMV) who has better knowledge of that information. Therefore we do not go more deeply into our response in the understanding that CESR will be going further into this particular matter among its members.

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?

Transparency is an asset that has been achieved by highly developed markets in their improvement process. Transparency standards are positive for all market participants: issuers, financial institutions, intermediaries, investors, etc. and, in short, produce wealthier and more competitive market environments.

As a general principle and in order to fully reap the benefits of increased transparency, we believe that transparency obligations should be imposed on all bond markets segments and investors, following the same principle that MiFID applies in rules governing transparency obligations for shares.

It is true that bonds may present some market structures, classes of investors and transaction types that may make a tailored transparency regime advisable so as to avoid the potential setbacks that a “one size fits all” approach might pose.

MiFID framework for shares transparency acknowledges a similar problem and allows a number of waivers, thresholds and delays based on the liquidity of the share, the type of the transaction, the size of the transaction and the features of the trading venue.

Therefore we believe that the approach should not be to extend mandatory transparency only to certain market segments or investors, but to provide for the waivers, thresholds and delays on transparency obligations that better fit the specific features of bond markets.

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?

The abovementioned data highlight the importance and significance of all issues related to the extension of pre-trade and post-trade transparency requirements to fixed income markets and products, as well as the need to reach a regime fully consistent with MiFID pillars.

Any attempt to face such basic issues –which conform the framework that MiFID pursues– through self-regulatory solutions, will inevitably lead to different regimes that would weaken such transparency making it imbalanced and ineffective. Therefore, a common legal framework for all Member States drafted by the European Commission is required.

As a result, self regulation should be applied to the national enforcement of that common legislation, taking into consideration the way each market is organised and managed, as well as for the eventual introduction of stricter regulations than those foreseen in the common European regulations.

Finally, having in mind how straightforward the regulation approach was followed to cope with the transparency obligations for equities markets, it is very difficult to understand why a different solution, such as auto-regulation, should be undertaken for bonds markets.