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Report on CESR's Wholesale Day

Following the first meeting that took place in February 2006, CESR organised another "Wholesale Day" that took place in CESR's offices in Paris on 17 March 2008. CESR's Chairman, Mr Eddy Wymeersch, chaired the meeting. A wide range of industry representatives, including EuroMTS, Bloomberg, DTCC London, Moody's, other market participants identified by the relevant European associations and academics participated in the discussions. Also present was a representative of the Commission. A list of participants is provided in the attached Annex. This note highlights the main conclusions of the discussions.

The aim of this roundtable was to identify current major trends in the non-equity wholesale markets and their regulatory or supervisory implications (if any). The discussions will help CESR to shape its future work programme and to prioritise its future activities.

The wholesale day was organised in three sessions:

Session 1: Primary markets

Session 2: Secondary markets

- Trading venues
- Price formation and evaluation
- Risk analysis.

Session 3: Conclusions: Impact of public regulation on market choices

Each session was introduced by a few brief presentations given by invited participants. The following conclusions were drawn from the discussions and the presentations:

On primary markets

The current weak state of the asset-backed securities (ABS) markets was identified as the biggest problem of the primary markets at the moment. There was a steady increase in the issuance levels in the ABS markets until a fall in Q3 2007 followed by a very low issuance level in Q1 2008. The market is dominated by the high share of the UK and Spanish issues (more than 50 % of collateral) and the generally high ratings with 80 % of the issues having an AAA rating.

The current sentiment of the market can be characterised by a very low confidence level even though slight improvement is expected within the next three months. At the moment, the main concern for the ABS investors is the mark-to-market volatility which also makes it less likely for the investors to participate in the ABS market. Prices in the market differ between credit prices and liquidity prices. The widening of the spreads may not, per se, represent a significant problem to the market to the extent that positions do not have to be disclosed or liquidated.

In addition to the core ABS markets, the related asset-backed commercial paper (ABCP) markets are facing similar contraction. At the same time, the listings of the ABS issues are also declining whereas a similar fall cannot necessarily be identified in the standard products. The current market situation is not encouraging the emergence of new products.



The recent market-led initiatives (e.g. by the ESF) on increasing information on the primary market transactions were welcomed by the participants.

On secondary markets

The impact of MiFID on the secondary market trading of bonds is not similar to that of equities. This is due to the fact that the traditional **trading venues** (exchanges) do not have an important role in the bond markets. The trading methodologies are also largely determined by the nature of the market (B2B, B2C or retail). The new initiatives of some market participants (e.g. MTFs) will further increase competition which was welcomed by the market participants. No value was seen in imposing mandatory listing and trading on the exchanges but the general stimulation of trading on the secondary markets was seen as important.

The secondary market liquidity is best in the government bond market also because the governments have a strong interest in the liquidity of their bond issues. In the B2C markets that operate mainly on a request for quote basis the buy-side can have problems getting liquidity on their holdings.

The improvements in technology have addressed some of the liquidity problems due to the fact that the cost of competition in trading services has fallen as a result of this. Significant challenges lie in the post-trading services where OTC trading could also benefit from higher automation and standardisation. This was seen as an area where public sector could act as a facilitator for increased industry collaboration. In general, the clearing and settlement systems were seen as a source of inefficiency and the removal of the Giovannini barriers was considered to be a priority.

As a consequence of MiFID, the issue of **price formation** has been subject to various initiatives. The participants emphasised the fundamental differences in the nature of the equity and non-equity markets. In the price transparency of bonds, the focus should continue to remain in the retail market. However, for the valuation of bonds both initial and ongoing product disclosure is generally considered to be more important than price transparency. Especially in distressed markets, real-time price transparency might even be harmful. However, further analysis on the benefits of *ad hoc* post trade price transparency could be useful.

In **risk analysis**, the participants emphasised the importance of risks transferring to where there is capacity to manage them. There needs to be a balance between risk traders and risk absorbers in the market. The capacity of the latter to hold on to the risk should be encouraged especially when the markets are falling.

The importance of the risk shifting role of derivatives was also raised in the discussions. In order to ensure sufficient management of the ensuing counterparty risk, a closer look should be had at the various laws applicable to netting arrangements at both national and European levels.

On the impact of public regulation on market choices

The public regulation is normally a reaction to a market failure, i.e. a situation that cannot be solved by the market mechanism. The problem with this approach is that the market mechanism does not work properly during a time of crisis. According to participants, trying to solve the crisis by adding regulation at this point would bring more adverse effects than benefits. Instead, the regulators should focus on improving their early warning and crisis prevention systems as well as their ability to act on the basis of these signals.

Conclusions

The regulators rely on market participants in the identification of warnings and concerns in the functioning of the market. There is a joint interest in addressing inefficiencies as well as identifying and resolving as soon as possible any potential problems that might prevent the proper functioning of the market. For CESR it is useful to have a structured dialogue with market participants, via periodic meetings with open discussion.



ANNEX

**CESR Wholesale Day
Paris, 17 March 2008
Participants**

Association/Entity	Name of Participant
CESR Chairman	Eddy Wymeersch
CESR Secretary General	Carlo Comporti
CESR	Antoine van Cauwenberge
CESR	Eija Holttinen
EuroMTS	Angelo Proni
FESE	Marie-Hélène Crétu
FESE	Hubert Grignon Dumoulin
FESE	Carlos Angel López Marqués
FESE	Rafael Plata
Bloomberg	Axel Barret
DTCC London	Diana Chan
SIFMA	Stefan Loesch
SIFMA	Mark Austen
SIFMA	Donald Ricketts
FBE	Michael Hampden-Turner
FBE	Benoît Gourisse
LIBA	Susan Revell
LIBA	Abdel-Hamid Mazouz
ICAP	Godfried De Vidts
ISDA	George Handjinicolaou
ISDA	Roger Cogan
Moody's Cooperation	Nigel Phipps
EFAMA	Mr Franck Chatillon
EFAMA	Hubert Rotivel
	Avinash Persaud
European Commission	Stig Hesselberg