PRESS RELEASE

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TRANSPARENCY OF EUROPEAN BOND MARKETS

A cross market group of associations[1] has today published two independent studies on the corporate and government bond markets in Europe, *"**European Corporate Bond Markets: transparency, liquidity, efficiency**"* and *"**European Government Bond Markets: transparency, liquidity, efficiency**"*.

Recognising that these markets play a key role in the financial system, the studies were designed to investigate the extent to which their secondary markets operate efficiently and transparently and meet the needs of different market participants, including institutional and retail investors. The research was commissioned to inform the associations' input into the European Commission's review of non-equity market transparency, required by MiFID (Markets in Financial Instruments Directive) and due to be completed by November 2007. It was conducted by two teams of researchers under the auspices of the CEPR[2].

The study on the corporate bond markets concluded that:

- Euro-denominated bonds have tighter spreads than either sterling bonds or their US counterparts.
- Competition is a key driver of liquidity, and this is where public policy should focus.
- To impose pre-trade transparency via regulation would be risky, as it would require significant changes to the microstructure of the market.
- Greater post-trade transparency would benefit some market participants but should be designed and implemented carefully and be market-led if possible.

Bruno Biais, Professor of Finance at the University of Toulouse and an author of the corporate bond market report, commented,

"Our study suggests that the supply of liquidity in the euro-denominated bond market is rather competitive, resulting in tight spreads for institutional size trades. The situation is different in the sterling-denominated bond market. Our results underscore the benefits of the integrated euro market, in terms of liquidity and competition."

The study on the government bond markets concluded that:

- The secondary market microstructure is heavily influenced by the relationships between issuers and primary dealers.
- Where transparency is high, trade size tends to be low. Where primary dealer obligations are greatest or where syndication is used heavily, this provides better liquidity and low spreads, but worse execution quality for large trades. Effective spreads in the US Treasury market are lower than on MTS, except for the long benchmark.
- The differing levels of transparency seem appropriate for all major market participants.

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- The study suggests that regulatory imposition of greater transparency could adversely affect liquidity in the government bond markets.

Richard Portes, Professor of Economics at the London Business School and an author of the government bond markets report, commented,

"Regulators should be cautious in intervening in the government bond markets. They are best left to evolve further themselves, in line with future technical changes and changes in the structure of the markets."

Both studies concluded that imposing change through regulation would be risky. Ideally, the market itself could lead such changes. The commissioning associations expect to do further work in this area.

Click here for a copy of *European Corporate Bond Markets: transparency, liquidity, efficiency* and here for a copy of *European Government Bond Markets: transparency, liquidity, efficiency.*

The researchers are available for interview on Tuesday 23 May at 10.30am at CEPR or by telephone. For further information contact Robbie Lonie at CEPR as below.

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Notes to Editors

1. The commissioning associations are the Association of British Insurers, City of London, European Primary Dealers Association, European High Yield Association, International Capital Market Association, Investment Management Association and the London Investment Banking Association.

The **Association of British Insurers (ABI)** is the trade association representing the UK insurance industry. Its members include large institutional investors controlling funds worth some €1,600 bn, including large holdings of corporate bonds.

The **City of London** provides local government services for the Square Mile, the financial and commercial heart of Britain. The City is committed to maintaining and enhancing the status of London as the world's leading international financial and business centre through its policies and services.

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The **European Primary Dealers Association (EPDA)** is the trade association representing primary dealers in the euro zone government bond market. The EPDA is an affiliate of the Bond Market Association.

The **European High Yield Association (EHYA)** is the trade association representing banks, investors, issuers, rating agencies, law firms, accounting firms, financial sponsors and other participants in the European high yield market. The EHYA is an affiliate of the Bond Market Association.

The **International Capital Market Association (ICMA)** represents financial institutions active in the international capital markets, with over 400 member firms drawn from some 50 countries.

The **Investment Management Association (IMA)** is the trade body representing the UK asset management industry. Its members include independent fund managers, the asset management arms of retail banks, life insurers, investment banks and occupational pension scheme managers.

The **London Investment Banking Association (LIBA)** is the principal trade association in the United Kingdom for firms active in the investment banking and securities industry, including the major international investment banks which base their European operations in London.

2. The research was commissioned from the **Centre for Economic Policy Research (CEPR)**, a non-profit network of 700 economists based in Europe. Professor Bruno Biais of the University of Toulouse led the research on European corporate debt markets, and Professor Richard Portes of London Business School led the research on government debt markets.

3. **MiFID (Markets in Financial Instruments Directive)**

MiFID is a major plank in the European Commission's Financial Services Action Plan (FSAP). The purpose of the FSAP is to finalise the single market in financial services in Europe, thus contributing towards the EU's goal of achieving a significant increase in economic growth by 2010.

One significant part of MiFID brings in changes to the transparency regime for trading equities. The impact cannot yet be assessed, but early analysis suggests that it will be far reaching, affecting how, and how much, liquidity is provided to the market and potentially tilting the competitive balance between firms, exchanges and data vendors. Article 65(1) of MiFID requires the European Commission to submit a review to the European Parliament on the possible extension of the scope of the transparency provisions to non-equity markets.