International
Capital
Market
Association

ICMA

Committee of European Securities Regulators
11-13 Avenue de Friedland
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France

4 June, 2010

By email

Re: ICMA Response to CESR Technical Advice to the European Commission in the context of the MiFID review: Non-equity markets transparency

Dear Sirs,

We thank you for this opportunity to express our views on this important topic. As a self-regulatory organisation in Europe, we are keen to work with the regulatory authorities. For over 40 years, ICMA has facilitated interaction between market participants for the benefit of an efficient and well-functioning international securities market. ICMA's objectives are the promotion of "best practices" and standards, contributing to education, helping supervisory authorities and furthering links between members.

Given the importance of transparency to the well-functioning of the corporate bond markets and our members, and the range of issues that were raised by the CESR Consultation Paper of December 2008 and Report of July 2009, ICMA felt it important to fully explore these issues with our members. Moreover, we felt this was of particular importance given that the Commission had indicated to us that they felt they had insufficient information about buy-side concerns, especially from mid-size and smaller buy-side firms. Accordingly, we launched an electronic survey for the industry at the beginning of April. The survey related solely to the European corporate bond market (both senior and subordinated debt). We have analysed the data and a summary is attached. We are only responding to Q1 – 12 of the consultation paper and in doing so our responses are based largely on the responses to our survey.

We received 69 completed responses to our survey. As part of the survey, we asked participants to identify their role in the market as buy-side, sell-side, repo or other. 41% of respondents were buy-side, 36% were sell-side, 13% were repo/securities lending and the remaining 10% were "other" which included exchanges, issuers and underwriters. Participants were also asked for the name of their firm which showed that respondents also came from a very diverse range of firms - from very large, to mid-size and small buy-side and sell-side firms across Europe (respondents were based in 16

jurisdictions across Europe including Belgium, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, etc.) Finally, participants were asked to indicate what percentage of their corporate bond business, by value, was with retail clients (as defined by MiFID). The answer to this question showed considerable variation. However, for half of buy-side, sell-side and repo respondents, retail clients amounted to less than 35% of their business.

Sources of pre- and post-trade information - Q1

A large number of services exist in relation to corporate bonds that provide a high degree of pre-trade transparency to market participants. These services include "dealer pricing runs" that will often be organised and presented by third-party providers (such as Bloomberg, Markit, ThomsonReuters, CMA/QuoteVision/DataVision etc.) who will create stacks displaying the best price and depth of quotes. The price that is displayed in the dealer pricing run is not executable per se so investors will contact the dealer/s displaying the best price and volume directly (Request for Enablement or Request for Quotes). However, even though the prices displayed in the dealer pricing runs are not executable, dealers face reputational issues if they fail to stand behind their prices and they therefore have a commercial incentive to ensure that they execute within their published quotes. In this regard, Bloomberg and Thomson Reuters have functionality to distinguish between firm and indicative quotes, and this being developed by other services such as MarketAxess.

There are also electronic execution platforms that are widely used in the European dealer-to-client market. The most widely used electronic execution platforms are Bloomberg, TradeWeb, BondVision, MarketAxess and TLX. These platforms receive and aggregate dealer prices, allow clients to select the best price and to raise RFQs or orders to single or multiple dealers. In addition, there are also "bids wanted in competition" (BWIC's) and "offers wanted in competition" (OWIC's) which are lists of positions sent by clients to multiple dealers to seek competitive bids in order to achieve the best possible price. The lists are exchanged and prices sought on electronic platforms such as Bloomberg and TradeWeb, that allow clients to e.g. select the dealers for the quote request, define the time by which prices must be received, identify best prices and initiate execution following selection of the best price.

There are also aggregate/composite pricing services where commercial vendors provide daily mid market intra-day and end of day pricing based on levels aggregated across various dealer providers. These prices are not executable but provide an indication of the market. Common vendors include Markit, Bloomberg and CMA. Additionally, Iboxx indices, managed by Markit, provide a range of indices for cash bonds, including e.g. EUR, GBP, USD, high yield, sovereign, emerging markets and Asia indices. Iboxx bond indices for EUR and GBP use intra-day bid offer process provided via automatic price feeds from each bank's bond desk. The prices are consolidated by Deutsche Börse, calculated every minute and disseminated immediately to the market via data vendors. There are also dealer provided bond indices.

Finally, there are a few services that provide post-trade data (i.e. actual trade prices), such as Xtrakter, www.bondmarketprices, and SIX Telekurs.

Scope of the corporate bonds transparency regime (i.e. both pre- and post-trade) – Q2 – Q3

We understand from the CESR Open Hearing on non-equity markets transparency that CESR feels that the consultation proposals should also apply to sovereign bonds. We feel that a transparency framework that applies equally to both corporate and sovereign bonds would be sensible.

Given that CESR now feels the regime should apply to both corporate and sovereign bonds we wonder whether the question regarding the definition of corporate bonds is still valid. Nevertheless, our thoughts are as follows. The consultation paper defined a ***corporate*** bond as a "transferable debt security issued by a private corporate to raise capital with a maturity of at least 12 months". First, we would suggest that the definition of "private corporation" that you use should be broad enough to encompass a wide variety of legal forms but not capture debt instruments issued by public sector issuer such as supra-national agencies, sovereign issuers, etc. [We are assuming that CESR would develop a separate definition to cover sovereign bonds.] We also note that there are a number of quasi-public issuers whose roles have evolved over time. For example, many infrastructure providers would have historically been considered to be public sector issuers but today such issuers can be independent of government and will, in certain circumstances, be considered to be private organisations. Any transparency framework would need to be flexible enough to accommodate for such changes between private and public entities.

We also note that the suggested definition includes a limitation that the security is issued "to raise capital". The CESR consultation does not explain why this limitation has been included or why it would be relevant. We would recommend that this limitation does not form part of the definition of "corporate bond". We also note that the proposed definition is limited to debt securities with "a maturity of at least 12 months". However, the recently issued CESR guidelines on a common definition of European Money Market Funds uses a period of 397 days or less in relation to money market funds. We would urge the need for consistency in relation to the definition of "corporate bond" and those used for money market funds. In this regard, it may be simpler if the period used for both contexts was 12 months rather than 397 days.

We note your proposal to define the scope of the transparency regime by using the criterion of whether a prospectus has been published (i.e. including all corporate bonds admitted to trading on EEA RMs) or which are admitted to trading on a MTF. Accordingly, you may be interested to know that the ICMA survey asked respondents to indicate (1) whether a post-trade publication scheme should relate to all corporate bonds or only some corporate bonds and (2) if the latter, what criteria should be used to determine which bonds to include in a post-trade transparency scheme. The buy-side expressed slightly stronger preference for all corporate bonds to be included while the sell-side expressed mixed views. Repo participants and others preferred that all corporate bonds be included in the scheme. For those respondents who suggested that only some corporate bonds be included in the scheme, sell-side respondents expressed most support for using size of issue as a way of defining scope, followed by frequency of trading in the bond. Use of a prospectus was the least favoured option amongst the sell-side. On the other hand, buy-side respondents expressed support, in roughly equal measures for each of the following criteria (1) type of bond i.e. senior /subordinated debt etc.; (2) frequency of trading in the bond; (3) amount of trading in the bond; (4) existence of a prospectus; and (5) size of issue. Repo market participants were similarly supportive of all the

options, with type of bond and frequency of trading being most popular while amount of trading being least popular. On an aggregated basis (i.e. if you do not divide up the responses according to buy-side, sell-side and repo), the most favoured option was size of issue (28% respondents), closely followed by frequency of trading in the bond (22% respondents), while the least favoured option was existence of a prospectus (12% respondents).

We note that CESR has repeatedly stressed that a post-trade transparency regime "be sensibly calibrated to minimise any negative impact on liquidity". The European corporate bond market covers hundreds of thousands of bonds, the vast majority of which have a prospectus. Accordingly, the suggestion that the scope of the framework be limited to those bonds which have a prospectus published or which are admitted to trading on an MTF is arguably not a meaningful limit. Moreover, given that our survey indicates that the least favoured criteria for determining which bonds to include in the scheme was existence of a prospectus, we would urge CESR to reconsider this as the basis for defining the scope of the framework and consider using size of issue or liquidity of the instrument instead.

You also asked about the inclusion of covered bonds within the transparency framework. Covered bonds are, in the first instance, a claim on the issuer (i.e. corporate bonds). The "cover" only comes in the case of a failure to pay – unlike a structured finance product where payment typically depends directly on the performance of the asset pool (with no claim on the issuer for any shortfall). You will be aware that the ECB's April 2010 Report on Financial Integration in Europe[1] stated:

> "In contrast to asset-backed securities (ABSs), there is no credit risk transfer to the bondholder. Another difference is to be found in the fact that covered bond issuers are obliged to safeguard a certain value of the covered bond holders' collateral. Issuers of covered bonds are liable for all payments of interest and principal, which is why investors benefit from double protection against default. ... The main advantage of covered bonds can therefore be seen in reduced funding costs for banks and usually high standards of investor protection."

Accordingly, in many jurisdictions in Europe covered bonds can be considered to be retail products rather than wholesale products and therefore we feel that it would be appropriate for these instruments to be considered to be corporate bonds for transparency purposes. Moreover, it would be a curious conclusion for bonds issued by e.g. HSBC to be included within the transparency regime, but not the covered bond for HSBC, especially when the covered bond is designed in a way to be a safer instrument, from a retail perspective. However, it is important that any investors accessing a transparency framework are made aware of the differences between corporate bonds and covered bonds, not least of which will be differing legal regimes, bond fundamentals and in many cases, different credit ratings and thus risk profiles.

[1] http://www.ecb.int/pub/pdf/other/financialintegrationineurope201004en.pdf

Pre-trade transparency questions – Q4 - Q8

The ICMA survey asked respondents a number of questions concerning pre-trade transparency.[2] For example, respondents were asked what their most important considerations are when trading. Both buy-side and sell-side participants ranked pre-trade transparency as more important than post-trade transparency. This is because knowing the best price at which market participants can do a trade (or at least know which dealers are interested in providing a quote for a particular bond) is more important than knowing the price at which someone else has done a trade. Participants were also asked what measures could improve liquidity in the corporate bond market. Overwhelmingly, 83% of all respondents were of the view that better pre-trade transparency could improve liquidity. Far fewer respondents in total (57%) believed that better post-trade transparency could improve liquidity. In addition, the ICMA survey asked whether greater pre-trade transparency would have a positive, negative or no impact on the market. Overall, respondents felt that greater pre-trade transparency would have a positive impact on liquidity, market depth, and bid/offer spreads.

On the basis of the ICMA survey, it is clear that ***access*** to pre-trade information is not an issue – as set out above, pre-trade market data is available through a number of sources that disseminate information electronically and on a continuous basis. For wholesale market participants (whether buy-side, sell side or repo), accessibility is through these various platforms that virtually all market participants have access to and while such services may be costly, they are nevertheless widely accepted one of the costs of doing business in this market. Moreover, our members have made clear that the ***amount*** of pre-trade information is also adequate. Therefore, we would stress that there are no identified market failures in relation to pre-trade transparency for corporate bonds. Rather, comments made by market participants in relation to pre-trade transparency are:

(1) Bid/offer quotes displayed on platforms may be either firm or indicative quotes and the systems do not distinguish adequately between the two;

(2) Bid/offer quotes displayed on platforms can be stale;

(3) Buy-side participants should have greater ability to post bid/offers on pre-trade systems;

(4) Bid/offer quotes displayed on Reuters/Bloomberg are sometimes subject to change once the dealer knows the side/size (the size is usually indicated beside the quote);

(5) Market makers may no longer provide prices if obliged to post firm quotes which may cause repo markets to dry up and long-only investors to stop lending securities; and

(6) Market makers should be able to price improve for larger sized trades. However, the converse of this is that if the buy-side are looking to transact in small volumes, they should not expect to be able to trade at the same price as they would get for large volumes – i.e. there is a price differential based on the size of a transaction.

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[2] Defined as information that is made available to the market as a whole that concerns trading interest – i.e. the bid and offer prices and quantities in which market participants are willing to trade. Post-trade transparency, on the other hand, refers to information about trades that have already taken place, such as the price that was paid for the corporate bonds in a particular trade.

Retail clients obtain pre-trade transparency through their brokers. The website http://www.investinginbondseurope.org/ also provides free access to pre-trade transparency for retail participants. However, it should be kept in mind that in many jurisdictions in Europe, the corporate bond market has very limited retail participation. 63% of the traders who answered the survey (i.e. buy-side, sell-side and repo) indicated that the percentage of their business, by value, that was with retail clients was less than 35%. Only 1 out of 69 respondents indicated that 100% of their corporate bond business was with retail clients. In this context it is worth reiterating that the respondents to the ICMA survey were based in 16 jurisdictions across Europe.

It is worth noting that one of the measures that respondents to the ICMA survey felt could improve liquidity in the corporate bond market was electronic trading. 87% of all respondents felt that electronic trading would improve liquidity in the corporate bond market. It is also worth emphasising that 80% of respondents to our survey felt that regulatory intervention would not improve liquidity in the corporate bond market. Accordingly, we would urge that any improvements to be made in the pre-trade transparency space be developed through industry solutions rather than regulatory intervention.

Post-trade transparency for corporate bonds – Q9 – Q12

We note that the CESR consultation does not ask for views about the merits of establishing a post-trade transparency framework. Accordingly, we do not comment on this issue in this section of our response.

On Question 9, our members have indicated that the notional value could be made accessible to market participants in respect of retail trades only.

In relation to the other questions on post-trade transparency, it is worth noting that the ICMA survey asked respondents about when price data should be published. The majority (57%) of respondents indicated that price data should be published end of day. This was particularly pronounced for buy-side respondents where 64% of buy side respondents felt that end of day pricing was ideal. Relatively few respondents suggested that price data should be published close to real time or real time. The survey also revealed a strong preference amongst all market participants for high/low/median end of day prices rather than actual trade prices or aggregate trade prices.

Survey responses on trading volumes were more mixed. In response to the question about whether trading volumes should be published, the sell-side felt that volume data should not be published whereas the preference of buy-side and repo participants was for aggregated volumes by bond to be published. However, the preference of most market participants was for trading volume data to be published (77% of all respondents favoured publication) with a delay of end of day as opposed to wanting more timely publication.

The Survey also asked whether there should be a delay in publishing price and/or volume data for large trades. Buy-side responses were mixed; sell-side respondents and others supported a delay while repo respondents supported no delay. One sell-side respondent was of the view that large trades should not be disclosed as to do so would seriously impact willingness of dealers to provide liquidity. Curiously, the strongest preference on both the sell side and buy side was for a time delay

of end of day whereas the strongest preference for repo and others was for end of next day, though we also received a number of comments that the larger the trade the longer the delay should be (e.g. over €1 million = end of next day; over €5 million = 5 days etc.). It is worth noting that these sentiments were expressed by both buy side and sell side respondents and by the larger market participants who provide the greatest liquidity to the market. There was no consensus on how large trades should be defined and the range of suggestions included:

(1) Trades over €1 million/€2.5 million/€3 million/€5 million/€10 million/€25 million /€50 million;

(2) Trades greater than 3% - 10% of issue size/ percentage of notional outstanding/ percentage of volume issued;

(3) Trades greater than a multiple of normal market size/ average trade volume.

Therefore, on the basis of our members' preferred view, if there is to be a post-trade transparency framework, we suggest that it should be calibrated as follows:

(1) Scope to include either all corporate bonds or those bonds of a certain issue size;

(2) High/low/median price data to be published end of day;

(3) Aggregated volume data to be published end of day;

(4) Time delay for large trades of end of next day and the larger the trade the longer the delay to accommodate large/block trades;[3]

(5) Large trades defined either on the basis of trade size over certain threshold e.g. 5 million or trades greater than e.g. 10% of issue size.

If, instead, a post-trade publication scheme is designed in the way currently envisaged by CESR, we would recommend that the threshold delineating retail from wholesale trades be reduced from the current proposal of €1 million down to €300,000 or possibly even less. Note that some respondents to our Survey suggested that large trades be defined as trades in excess of €1 million. We understand that the FSA has carried out some research that indicates that the average trade size is well below this level, which would support a reduction of the threshold.

Other comments

It should be noted that our Members fully support greater transparency of post-trade data to ***regulators*** – this includes all transaction data including size, date and time data. However, there is genuine concern amongst our members that publication of post-trade data to the ***market*** as a whole, especially without adequate delays for less liquid bonds or for larger/block trades will

[3] In this context it is worth emphasising that given the significant differences between equity and corporate bond markets, the time delay for large trades in the two markets should not be the same. Some accommodation should be made for the fundamental differences between the two markets.

negatively impact on liquidity. As you will see from our survey, the most important criterion for all market participants is liquidity whereas post-trade transparency ranked fairly low for all respondents. Moreover, respondents to our survey also agreed that out of a range of measures that could improve liquidity, improvements to post-trade transparency were not high on the list of priorities whereas electronic trading, larger issue size and improvements in pre-trade transparency (as discussed above) all ranked significantly higher. Given these results, combined with the clear preference of respondents for end of day, high/low/median prices and aggregated volumes the question that must be asked is whether the cost of imposing a more rigorous publication regime can be justified by the supposed benefits. In this regard, we note that neither the current CESR consultation nor the December 2008 consultation and July Report contained any form of cost benefit analysis. Accordingly, we would urge CESR to consider not only the costs to the industry but also the costs to the regulators themselves in developing the requisite IT systems to handle the vast amounts of trade data from ***all*** the asset classes considered by this consultation, some of which could potentially be on a real-time basis. Regulators and market participants risk a flood of data that few will be capable of analysing. Also, we would strongly urge the need for consistent transaction reporting obligations across Europe in order to minimise costs to the industry.

We also understand from the CESR Open Hearing that the FSA has carried out an assessment of current levels of liquidity in the market so that it will be possible to assess the impact of the proposed transparency framework post-implementation. It would be helpful if the FSA could publish the work it has done to date in this regard. It is also worth noting that many market participants believe that TRACE has had a negative impact on liquidity in the US, as more post-trade transparency promotes the "winner's curse" – the ability to trade in large/block size is impacted because after the first block is traded, everyone 'knows'; the people seeing the information are those with the least skin in the game; the winner is more at risk, since others know where/how much was traded and finally, those who didn't win the price can push the market against the winner so he will be less willing to show as good a price.

Given the concerns of market participants that greater transparency could negatively impact on liquidity, we recommend the adoption of a phased approach so that if it becomes clear that greater transparency is having a negative impact on liquidity only a small segment of the market will have been affected. If this idea were to be looked upon favourably by CESR, we would recommend that the transparency regime initially focus on transactions under €1 million which would encompass a significant proportion of trading activity and include the vast majority of retail trading in particular. Additionally, if a post-trade publication scheme as currently envisaged by CESR were to be set up it would be helpful if, in the sub-€1million category, retail trades could be distinguished from wholesale trades.

Finally, we note that there are still a significant number of technical details that would need to be considered before a framework could become operational. For example, a participant at the CESR Open Hearing raised the issue of how asset swaps should be reported. In this regard we would emphasise that the transaction data the market may find useful will not always be the same as the transaction data a regulator would want to see. Similarly, where a firm aggregates client trades into a block trade, it should be the block trade that is made pubic rather than individual client trades publication of which would be potentially misleading. Further thought would also need to be given to whether end of day reporting should apply for large trades that are agreed just before end of day

– it would seem unfair to penalise the participants of such trades by requiring the trade details to be published almost immediately. These, together with a range of other issues all need further clarification.

We hope that our response is of assistance. If you have any questions or would like additional clarification on either this response or our survey, please do not hesitate to contact me.

Yours sincerely,

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