

BN10-04

MiFID Review – Transparency in Corporate, Covered and Government Bonds

Background

As part of its 2010 review of the Markets in Financial Instruments Directive (MiFID), the European Commission is expected to propose legislation extending transparency requirements into the non-equities markets. The Committee of European Securities Regulators (CESR) will provide technical advice to the Commission in the context of non-equities markets transparency and has consulted on the following markets: Corporate Bonds, Structured Finance products (ABS and CDOs), Credit Default Swaps (CDS) and Derivatives (Interest Rate, Equity, Commodities and Foreign Exchange).

AFME's general position on all aspects of non-equities transparency apart from structured finance is set out in Briefing Paper BN10-03. This paper specifically covers the bond markets.

AFME's position

There is already a high level of pre-trade transparency in the bond markets. Most banks quote live two-way prices to clients throughout the day. Additionally, pre-trade market data on bonds is available through a number of sources to all market participants or indeed to any other users from the commercial pricing providers. This is further supported by the AFME Liquidity survey conducted in February 2010. **Investors, in general, may have more pricing data available to them than the dealer market participants** due to the fact that they receive prices from multiple banks.

A number of **services exist to provide a high level of pre-trade transparency** to market participants, including: dealers' runs, parsing services, indices providers (such as Markit), price aggregators (such as Markit and Bloomberg), electronic service (TradeWeb, Bondvision, MarketAxess, and Bloomberg), "Bids (and Offers) wanted in competition". For illiquid corporate bonds, clients are able to raise "Request-for-Quotes" from multiple dealers and select the best price from the received quotes.

For retail investors, a lot of information is freely available on the websites of the specific platforms, for example, Euro TLX, Borsa Italiana - MOT and London Stock Exchange: ORB. Retail investors also benefit from public access to the prices of some of the interdealer platforms, albeit sometimes with a slight delay. Furthermore, several websites specifically target the information needs of the retail investor such as InvestinginbondsEurope.org and Bondmarketprices.com.

Pre-trade transparency in market segments which are illiquid and not accessed by retail could severely damage participants' willingness to provide an execution service. Execution prices are normally negotiated bilaterally due to constraints on supply and ability to liquidate inventory. Price discovery in these segments across all asset classes is a delicate process and its demise due to any sweeping "one-size fits all" approach could be a retrograde step. Delayed post execution transparency would need to be appropriately detailed so as not to potentially mislead participants or destroy the market segment.

Dealers and investors increasingly use electronic trading platforms for trading the most liquid and most standardised instruments. AFME believes that any new regime for post trade transparency should begin within this scope of bonds enabling regulators to assess the impact before expanding into a wider universe of OTC transactions.

We also strongly recommend adequate calibration to determine the liquidity of a bond before including into the reporting regime. We believe features such as aggregating the price information, implementing adequate reporting delays and withholding volume information on larger and less liquid transactions will help to protect the positions of those who choose to trade to larger or less liquid bonds, without being exposed to market, whilst still providing post trade price data on the transaction.

We also recommend introducing the post trade reporting regime in phases. This should begin with the most liquid instruments trading on electronic trading platforms. It should operate within size thresholds where the market can absorb the increase transparency without any negative impact on liquidity. AFME believes, for government bonds, the threshold could be applied for trades Eur1mm and under. AFME suggests one potential approach as follows:

- Phase 1- small sizes, close to real time, electronic trades,
- Phase 2 - larger sizes with simple liquidity filter, electronic trades
- Phase 3 - larger sizes, with simple liquidity filter, non-standard transactions filter, OTC trades

Useful Publications

CESR Technical advice to the European Commission in the context of the MiFID review - Non- equity markets transparency

AFME Fifth Annual Market Liquidity Fixed Income Survey

AFME/ EPDA Price Discovery and Market Guide for the European Government Bonds Market

AFME Briefing Note BN10-01: MiFID Review

AFME Briefing Note BN10-02: MiFID Review – Equity Markets

AFME Briefing Note BN10-03: MiFID Review – Non-Equities Transparency

AFME Briefing Note BN10-05: MiFID Review – Transparency in Credit Default Swaps

AFME Briefing Note BN10-06: MiFID Review – Transparency in Interest Rate Derivatives

AFME Briefing Note BN10-07: MiFID Review – Transparency in FX Derivatives

AFME Briefing Note BN10-08: MiFID Review – Transparency in Equity Derivatives

AFME Briefing Note BN10-09: MiFID Review – Transparency in Commodity Derivatives

Papers in Progress

AFME Price Discovery and Market Guide for the European Corporate Bonds Market

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