Mr David Wright
Director, Financial Services Policy and Financial Markets
Directorate General Internal Market and Services
European Commission
107 Avenue de Cortenbergh
1049 Bruxelles
BELGIQUE

Paris, 15 September 2006

BG/CJ – n° 2157/Div.

AFG RESPONSE TO EUROPEAN COMMISSION CALL FOR EVIDENCE REPORTS ON PRE- AND POST– TRADE TRANSPARENCY PROVISIONS OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE IN RELATION TO TRANSACTIONS IN CLASSES OF FINANCIAL INSTRUMENTS OTHER THAN SHARES

Dear David,

In response to your questionnaire please find below the Association Française de la Gestion Financière (AFG)[1] answers on the subject at hand.

---

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include management companies and investment companies. Some are entrepreneurial ones; others belong to French or foreign banking, insurance or asset management groups. AFG members are responsible for the management of over 2200 billion euros in the field of investment management - making the French industry a leader in Europe for collective investment in particular (with more than 20% of EU investment funds assets under management) and the second at global level after the US, in terms of financial management location (wherever the funds are domiciled). In the field of collective investment, our industry includes – beside UCITS – a significant part of products such as hedge funds, real estate funds and private equity funds. We are also a member of the European Fund and Asset Management Association, EFAMA.

Question 1: Do you have any comment on the proposed scope of the Report?

We agree with the scope defined by the European Commission. Studying financial instruments other than shares admitted to trading on a regulated market in order to highlight potential failures on the markets where these instruments are dealt is indeed essential.

This being said, each instrument pointed out by the European Commission is deeply different from the others – even if there is a certain linkage between each class of instrument, especially between cash and derivative markets.

It is very important to conduct a case by case analysis and to avoid applying the MiFID transparency provisions to transactions in all classes of non-equities instruments in the same way.

In the event some actions should be taken by regulators, they should take into account, as far as possible, the specificities of the instruments to bring answers tailored to each case.

Question 2: Do you consider this classification scheme to be sufficient for the purposes of the review?

The classification scheme established by the European Commission is large enough to allow a fine tuned analysis of the various instruments and markets.

As CDS, IRS and bond future are not carrying the same underlying risks, it will be better to distinguish them. However it would make sense to classify the ABS and the Investment Grade Corporate Bonds under the same category.

Question 3: Do you consider there are possible policy rationales for mandatory transparency we have not listed?

No

Question 4: Do you agree with our proposals for prioritisation of the review?

In terms of retail investors' protection, we agree with the classification scheme proposed by the European Commission. However even if bonds markets are essential for the long-term investment and retirement plans to individual investors, the experience shows that retail investors are not directly the main investors on these markets. The retail investors' flows linked to markets where instruments pointed out in this call for evidence are dealt, are very low and even nearly inexistent.

As an example, in France, the efforts to open the "Obligation Assimilable du Trésor" market to the retail investors led only to a very slight increase of the participation of individual investors in this market.

Our members think that bonds markets and the other markets highlighted in this call for evidence are structurally designed for professional investment managers. These markets are OTC markets where counterparties of deals are large investment banks or specialized voice brokers and this can explain why retail investors cannot be the main investors on these markets, even if these markets were more transparent.

In addition, the structuration of the products dealt on those markets is complex more often than not. Such a complexity of products also explains why such markets remain markets for professionals to a very large extent.

We would suggest another classification scheme to take into account the maturity and liquidity of these markets:

- ✓ cash government bonds;
- ✓ credit default swaps, interest rate swaps (nb : some level of transparency already exists since these products are admitted to trading on an organized market);
- ✓ cash investment-grade corporate bonds;
- ✓ cash high-yield corporate bonds;
- ✓ asset backed securities and ;
- ✓ other financial instruments, to the extent that respondents consider there are or may be problems that need to be addressed.

Bond futures markets are particularly liquid and transparent and even more transparent than their underlying cash market.

Question 5: To what extent do you consider there to be:

a. observable or demonstrable problems with respect to the possible policy rationales for mandatory transparency identified above in relation to one or more of the instrument markets under review?

Our members' point of view is to consider the different financial instruments on a case by case basis, and to distinguish between pre- and post-trade transparency.

A clear distinction should also be made between standard products and "tailor made" products. If the question of pre- and post-trade transparency is legitimate for standard products, it is hardly the case for products which are not market standards. Initially, it appears to our members that there is no need to deal with the question of transparency for instruments or contracts « tailor made » for one or few investors.

Another distinction should be made for standard products. The question of pre- and post-trade transparency is not so crucial for the less liquid standard products.

Indeed, our members are used to working with certain intermediaries (brokers or investment banks) on some deals because they know, by experience, that only these intermediaries are able to provide fair prices and adequate sizes on a particular issuance. If the rationale behind the proposal for an increase of transparency on these markets is to later oblige asset managers to ask more than one or two intermediaries for quotes on less liquid deals, it would conduct to harmful opposite effects (especially in terms of cost and time).

Our members consider that pre-trade information available via brokers and banks on the prices of not very liquid instruments is sufficient. There is no identified market failure on this segment of the market which could lead to the need of more mandatory pre-trade transparency. The post-trade transparency is neither useful on this market segment. A consequence of the lack of liquidity on certain issuances is that several hours or days can elapse between two deals. Putting in place « transaction cost analysis » based on price coming from transaction made at a different time and with a different size would be inappropriate. Post trade transparency, in this case, leads to erroneous conclusions and the level of information contained into the price will be very low.

On more liquid instruments, another distinction should be made between government bonds and corporate bonds.

Concerning government bonds, there is a lack of major stakes as this market, for our members, is efficient with a high degree of pre- and post-trade transparency on prices. Only one improvement in this market could be wished: getting a better vision of traded volumes. That would make it possible to correct some asymmetry of information between buy side and sell side, as the latter have, via the communications between brokers for example, a much broader vision of the conditions of market than asset managers. Prices coupled with the volumes exchanged on the markets obtained with more post-trade transparency would be helpful for the asset managers.

Concerning corporates bonds (and CDS market), managers still consider that the information provided by the banks and the brokers on the prices before the transactions is sufficient. There are no needs to improve pre-trade transparency on this segment of the market.

For post-trade transparency, our members wish indeed that it should be larger on this type of product. A TRACE-like system would allow managers to put in place more efficient cost analysis.

One example of improvement provided by such a system is the ability for the management of investment companies to quantify the added value of their bonds traders.

However, even if we could welcome, in this case, an increase in post-trade transparency, there is no need for a fast disclosure of deals' price. A one week delay seems to be sufficient for asset managers and for them a TRACE-like delay (15 mins) is inappropriate. The majority of our members consider that requiring an "immediate" post-trade transparency would go against their interests and those of their clients, especially by not preserving the confidentiality essential to a correct execution of the orders (for block trades essentially).

b. evidence that mandatory pre- or post-trade transparency would solve any of those problems?

As previously said, disclosing volumes on the bond markets would obviously reduce the existing asymmetry of information between sell side and buy side on these markets.

Regarding the more general topic of transparency on CDS and the most liquid corporate bonds, investment companies looking for prices have enough intermediaries to get an idea on the market price of the financial instruments they are looking for. Requesting opinions from different counterparties can negatively impact the investor's protection. Contrary to a common belief, the less an issue is liquid, the smaller number of counterparties should be consulted.

Getting a higher degree of post-trade transparency would lead to better analyses of prices practised by intermediaries. This could help to set up benchmarks to compare transaction costs. We wish to draw the European Commission's attention on the fact that an increase of transparency can only be implemented for specific products which are:

- ✓ Standardised;

- ✓ Liquid; the notion of liquid products could be estimated by the issuance's size, as these two criteria are highly correlated. There is no interest in setting up costly systems that would only collect information from only one or two deals a day (for less liquid bonds).

  A time period long enough between the deal and the publication of all the data relating to the deal should be respected. Investment managers strongly disagree with a short time period. Players on the market need a period of time long enough to keep data confidential in order to avoid, for example, front running and to allow execution of big size orders.

  In addition, in order to act in the best interests of the issuance holders, taking (opening) a position on the bond market or closing it should not be made public to the majority of the market participants. Otherwise, if all the other market participants knew the positions of this relevant player, they might act accordingly and create difficulties for this relevant player to manage its position.

Moreover, the market participants' experience on these specific markets has shown there is apparently no strong link between transparency and price liquidity.

The Euro market is far more liquid than the US market, therefore it's easier to make a deal on a euro-issuance rather than on a dollar (or sterling) issuance. The overall studies, although contradictory, which show a correlation between transparency, price and liquidity on the US market (since TRACE) can not be implemented on the Euro Market. Dealers on this market have a weaker pricing power than the US ones.

Finally, European directives (such as the Market Abuse Directive) already largely protect investors by prohibiting in Europe practices existing in the US (such as squeezes…).

Question 6: To what extent could recent and upcoming technological and market developments in relation to the instrument markets under review:

a. contribute to a relatively inexpensive extension of mandatory transparency?

b. render mandatory transparency unnecessary?

Asset managers consider that all the electronic trading systems (Markit, BondVision, ISMA…), quotes given by intermediaries and other information such as Bloomberg and Reuters are sufficient in term of pre-trade transparency whatever the financial instrument is.

Question 7: To what extent are non-equity financial instruments different from equities so that lower levels of mandatory transparency in those markets may be justified?

See above (question 4).

Question 8: What data sources do you consider relevant to the issues you have raised (if appropriate, cross-refer to your answers below)? Would you or your organisation be prepared to provide any relevant data if necessary?

According to our members, the main difficulty does not lie in the data themselves but rather in their consolidation. Market participants seem more equipped and able to compile data via clearing chambers (derivative products) and central custodians. It would be useful to get from these firms, on a regular basis, data on prices, volumes, etc. which are exchanged on different markets. That would favour the existence of a single European market for interest rate instruments.

The investment companies get a slight part of the data since they conduct a very little amount of transactions on markets other than share markets. The main transactions on these markets are conducted by banks and dealers. Therefore asking asset managers to provide for their data would not help to get a better transparency on the markets since other players on the markets have the data.

Q**uestion 9: Are there academic or institutional papers or ongoing work that should be considered in preparing the Report not included in our bibliography?**

See below

Question 10: What conclusions do you draw from the existing academic debate and the work being conducted by other interested parties?
See below

Question 11: In your view, how applicable is the academic or institutional literature concerning transparency in the cash equities markets to the present discussion?

We would welcome more academic research in these fields as the existing one, based on non US data, is not sufficient.

Question 12: What similarities, and what differences, are there between US and EU markets that should be borne in mind when seeking to draw inferences from the TRACE11 experience in the US?

See answer to question 5.b.

Question 13: To the extent that you have identified problems or believe that others might do so, do you agree that only EU-level action would be appropriate in the present case?

In case an action has to be taken, it should only be at EU level or worldwide. Any national option would lead to an uneven level playing field.

Question 14: If you have identified problems or believe that others might do so, to what extent do you consider those problems would disappear as a natural product of market evolution in the short-to-medium term?

In the absence of regulators' actions, it seems that the market will go anyway towards more post-trade transparency. Pre-trade transparency already exists on a large number of products where it brings an added value to these products.

Question 15: In respect of both pre- and post-trade transparency, are the four options the right ones to consider, and in particular should other options be considered?

<u>Pre trade transparency</u>: no other option

<u>Post trade transparency</u>: TRACE-like system where transactions on liquid, standard bonds are reported, with a minimal delay (1 week or more) and with all the information concerning the deal.

Question 16.: Would you, in light of your answers to the other questions, favour any of the four options in relation to pre- and post-trade transparency (or another option you might propose for consideration) in respect of transactions in any of:

• cash government bonds:

<u>Pre trade transparency</u>: no other option

<u>Post trade transparency</u>: more transparency on volumes.

• cash investment-grade corporate bonds:

<u>Pre trade transparency</u>: no other option

<u>Post trade transparency</u>: TRACE-like system where transactions on liquid, standard bonds are reported, with a minimal delay (1 week or more) and with all the information concerning the deal.

• cash high-yield corporate bonds:

<u>Pre trade transparency</u>: no other option

<u>Post trade transparency</u>: TRACE-like system where transactions on the most liquid, standard bonds are reported, with a minimal delay (1 week or more) and with all the information concerning the deal.

• asset-backed securities:

Pre trade transparency: no other option

Post trade transparency: no other option

• credit default swaps, interest rate swaps and bond futures:

Pre trade transparency: no other option

Post trade transparency: no other option

• or any other financial instrument you consider relevant?

Pre trade transparency: no other option

Post trade transparency: no other option

***

If you wish to discuss the content of this answer with us, please contact myself at 00 33 1 44 94 94 14 (e-mail: p.bollon@afg.asso.fr), our Head of International Affairs Stéphane Janin at 00 33 1 44 94 94 04 (e-mail: s.janin@afg.asso.fr) or his deputy Catherine Jasserand at 00 33 1 44 94 96 58 (e-mail: c.jasserand@afg.asso.fr).

Yours sincerely,

(signed)

Pierre Bollon