



September 2006

EUROPEAN COMMISSION'S CALL FOR EVIDENCE:

**PRE- AND POST-TRADE TRANSPARENCY PROVISIONS OF THE MiFID IN RELATION TO
TRANSACTIONS IN CLASSES OF FINANCIAL INSTRUMENTS OTHER THAN SHARES**
(12 JUNE 2006)

COMMENTS OF EURONEXT

Euronext welcomes the opportunity offered by the European Commission to comment in response to its Call for Evidence on the pre- and post-trade transparency provisions of the MiFID in relation to transactions in classes of financial instruments other than shares, preliminary to the Report to be published in accordance with Article 65(1) of the Markets in Financial Instruments Directive.

Transparency is indeed a cornerstone of the MiFID regime, and beyond its full implementation as concerns shares, we believe that the question of extending/applying some transparency provisions to the other types of financial instruments is both an important and difficult issue and should be handled with care. It seems indeed key that efficiency and security for investors are ensured, but also that existing well functioning markets are not disrupted by excessive constraints. The proper level of transparency will thus have to be determined depending on the instruments considered. A very detailed and practical analysis should be carried out in order to foresee, as precisely as possible, the effects (including on costs) of a change in the current levels of transparency on the various markets and instruments concerned.

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

We agree with the approach taken by the Commission to differentiate between classes of assets and to envisage the relevance of applying transparency provisions to other instruments than shares on a case-by-case basis.

Indeed, it is our general opinion that transparency is a benefit for the market in principle, but that the proper level of pre- and post-trade transparency may be different for the various asset classes and thus has to be adapted and fine-tuned depending on the nature of the instruments, as well as of the structure of the markets where they are traded, and the types of investors concerned - i.e. the retail and wholesale segments of the markets in question.

Overall, we concur to the Commission's view that any transparency provisions placed on different instruments may have to be tailored, thus resulting in different transparency regimes for various instrument classes. Indeed, the MiFID transparency regime should not be extended as such to all asset classes other than shares, but rather adapted, as a "one size fits all" approach will neither be possible nor in the best interests of any market participant. Equally, it is crucial to recognise the importance to overall market quality of facilities which enable the efficient execution of

“wholesale” trades (e.g. Block Trades, “Flex” trades¹, contingent trades such as basis trades or Exchange for Physical) which, by their very nature, require tailored transparency arrangements.

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

The classification scheme adopted by the Commission seems globally reasonable. Nevertheless, certain asset classes should also be considered: exchange traded funds (ETFs), warrants/certificates, convertible bonds.

Specifically on the derivatives side, we would have the following comments. First we would recommend that Forward Rate Agreements (“FRAs”) be included within “money market instruments”. This appears to be the most logical placement as FRAs are commonly associated as money market instruments. Second, we are wondering if there is a specific reason why equity derivatives (e.g. equity and index options) are not mentioned by the Commission, as some but not all of these products are heavily traded by retail investors.

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

We believe that the policy rationales for mandatory transparency identified by the Commission are the right ones and are rather exhaustively described in the Call for Evidence.

In particular, we share the view that transparency is important in relation to best execution, in order to make execution policies function correctly and update them.

In addition, the distinction between wholesale and retail investors has to be highlighted to distinguish policy rationales for transparency: the issue of ensuring a level playing field amongst investors/counterparties regarding pre- or post-trade information is particularly important for retail investors.

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

Some of the products are excluded on an “a priori” basis. We disagree with this approach. Before excluding the relevance of mandatory transparency for certain products, a detailed analysis of the existing transparency, and possible consequences of transparency or no transparency at all, should be carried out. In that context, the data to be disseminated should be adapted to the various types of products.

For instance, in our view, excluding ETFs and warrants/certificates from the scope *a priori* does not seem appropriate. These instruments are indeed heavily traded by retail investors. These two types of products nevertheless have different characteristics as regards their market, hence different needs for transparency could be determined.

An important part of the transactions in ETFs is done OTC with very limited transparency. Regarding the business done on exchange by retail investors, rules differ greatly from one country to the other. In that context, we consider that mandatory pre- and post-trade transparency is

¹ E.g. trades where the counterparties are free to agree the expiry date and sale price of an option within certain parameters set by the exchange.

important for such products. ETFs have indeed developed thanks to the level of transparency existing on the regulated markets, hence such transparency should be maintained.

Warrants/certificates are mainly retail products traded on-exchange, that have a fair level of transparency. This should be maintained. Pre-trade transparency is essential for products with a price difficult to be calculated or estimated by retail investors. For warrants/certificates, pre-trade transparency is therefore very important. Post-trade transparency would also be of particular importance, notably for best execution checks.

Regarding derivatives, pre- and post-trade transparency will be relevant for equity index options, when they are heavily traded by private investors, which is the case in some - but not all - Member States.

In general, we would stress that, for each instrument which is reviewed, the percentage of retail and wholesale market participants operating within this market should be identified - knowing that retail involvement in certain products may vary from one country to another. Any transparency provisions that are imposed need to be in the best interests of the majority of market participants.

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?

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

We believe the issue is not only to observe demonstrable problems or “failure”. It is also a question of maintaining the current transparency to maintain investor protection through best execution, and market efficiency/sound competition in an integrated market, especially in order to foster cross border trading.

Our view is that on retail traded financial instruments, complete pre-trade transparency ensures retail order flow and an adequate safeguard for the position of the retail investor.

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?

We do not have any comment on question 6.a, and are not aware of developments evoked in question 6.b.

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?

For a large percentage of derivative products, there is minimal retail involvement. As such, additional transparency provisions may not be necessary and in some cases could become more of a hindrance than a benefit to the users of the markets. As a result, this issue will need to be approached with care and a solution will need to be agreed for each market segment which reflects its structure and user base.

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?

Euronext would be willing to provide relevant data to support any of the answers given in this paper, itself or through its professional association FESE (Federation of European Securities Exchanges).

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

We do not have any comment.

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

In the economic literature views are divided on the way transparency impacts liquidity, transaction costs or price formation on the bond markets. Whereas some consider that transparency enhances liquidity (Pagano, Roell and Naik), others believe that it affects market efficiency (Madhavan, Bloomfield and O'Hara).

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

Issues and conclusions are very similar.

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 TRACE experience in the US?

We do not have any comment.

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?

EU-level action will ensure a harmonised approach to transparency across all EU Member States. This will hopefully facilitate a level playing field. This is particularly important as integrated transnational markets require similar rules and a level playing field across borders.

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 order to ensure investor protection, pre- and post-trade transparency is necessary for retail markets.

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?

We believe that post-trade transparency is important in most cases, in order to allow best execution, whereas for pre-trade transparency a more nuanced approach should be taken.

Therefore, with respect to pre-trade transparency, we would advise to determine “MiFID like rules” - not necessarily those of Article 27 - but adapted rules to the instruments concerned and however ensuring a level playing field among execution venues.

Concerning post-trade transparency, rules like MiFID ones would be useful in most cases.

In addition, we would be interested in further clarification on how the “self-regulation” option would work in practice. It is also unclear as to why, in the option suggesting a “mandatory MiFID-like system where volume information about trades is reported”, prices do not have to be reported...

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;
- cash investment-grade corporate bonds;
- cash high-yield corporate bonds;
- asset-backed securities;
- credit default swaps, interest rate swaps and bond futures; or
- any other financial instrument you consider relevant?

Within the derivative markets having limited retail involvement, there is strong resistance from participants of these markets to further transparency obligations. It can be believed that further obligations would not benefit the majority of these market participants and could potentially reduce liquidity in those markets.
