

“MiFID Non-Equities Market Transparency”

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- *The Financial Stability Forum (FSF) recently called securities regulators to work with market participants to study the scope to set up a comprehensive system for post-trade transparency* of the prices and volumes traded in secondary markets for credit instruments. The recent experience on sub-prime have showed that the opacity of trading conditions could have played a role and, in any event, does not pay in the long term. Therefore recent market turmoil had the effect to raise the issue once again on the benefits of greater market transparency, on the major differences between equities and bond markets, on the differences among jurisdictions and, in particular, on the role played by retail investors as well as on the effect that a transparency regime may have on liquidity.
- Regulatory analysis and initiatives now see International and European organisations again actively involved on bond market transparency.
- *It is difficult to find a transparency regime that makes everybody “happy”. Statements like “there is no evidence of market failures and therefore the transparency regime in place has to be considered sufficient and adequate” are not correctly posed and have proved to be out of date.* The industry usually emphasises the absence of any evidence on the presence of market failures, concluding that there is no need for a regulatory intervention in this area. However, as the experience have showed, *market failures could not represent the lead factor: rather than focusing on markets failures higher attention should be paid on whether markets could work better without any major liquidity drawback and what can be inferred from the observation of market trends.*
- *The design of a transparency regime for bonds is not an easy task* due to a number of factors that should be adequately taken into account:
 - the liquidity drawbacks;
 - the often unknown price formation process;

- the trade segmentation and market fragmentation;
- the complexity of products traded and of evaluation of different components and covenants.

Such difficulties could reasonably and actually lead to misleading information conveyed to market participants.

- ***An adequate knowledge of bond markets is essential to take any decisions in the area of transparency. These are the reasons why market-led solutions in this area should be welcomed. The industry has a deep and informed knowledge of market strategies and dynamics.*** However, ***market forces may fail to reach the adequate level of transparency (making bond markets opaque and not accessible to all type of investors) since they might gain from opacity, they might not have the proper incentives to reach the optimal outcome and they might not care enough about externalities.*** It should therefore be recognised that market participants might not have the proper incentives to reach the optimal outcome, as in the case of bonds issued by credit institutions where there are lower incentives to make the necessary information available and comparable.
- ***Proactive and coordinated analysis between regulators and the industry is necessary and*** it has been carefully taken into account in Italy to develop a transparency regime for financial instruments other than shares in the exercise of the option set up in MiFID, which allows member States to have a pre and post-trade transparency regime for financial instruments other than shares.
- The decision to extend the scope of the provisions of the Directive concerning pre and post-trade transparency obligations to transactions in classes of financial instruments other than shares has been taken by Consob taking into consideration the following main considerations:
 - (i) ***Italian markets have been characterised by a high level of transparency,*** higher than those required on other EU member States; ***any transparency regime that would have required lower level of transparency on bond markets could have represented a significant loss for Italian financial markets.*** Prior to MiFID implementation, Italian markets have been characterised by:
 - the concentration rule applied to all financial instruments (with the exception of governments bonds and financial derivatives) admitted to trading on regulated markets;
 - the distinction between regulated and unregulated (organised trading/ATS) markets;
 - transparency requirements for trading venues (regulated markets as well as unregulated ones) together with reporting obligations to regulated markets by investments forms concluding transaction off-market on financial instruments admitted to trading on regulated markets.

The result of the above approach has been a high level of transparency for all the financial instruments subject to the concentration rule and, therefore, also for bonds admitted to trading on regulated markets.

- (ii) ***the regulatory framework and the transparency regime in place in Italy have proved to work well in the past*** and, on the basis of the information available, did not have a negative impact on liquidity and investments strategies;
- In order to understand the major determinants of Consob's approach on non-equity markets transparency and trading venues/investment firms decisions in the area, it should be noted that ***in Italy bonds were (and are) traded on retail regulated markets, wholesale regulated markets, multilateral ATs and a number of bilateral ATs***. All the trading venues had a pre and post-trade transparency regime for transactions carried out on listed bonds, which was differentiated on the basis of the type of trading venue and participants (wholesale vs retail) and type of bonds traded. A certain degree of transparency was also available for unlisted bonds traded on ATs.
 - Some data might be useful to provide a picture of the importance of ATs in this area:
 - on 341 bilateral ATs, 313 were registering a daily average number of contracts which is less than 50; only 28 had a daily average number of contracts which was more than 50 and, among them, just 2 had greater than 500;
 - on 4 multilateral ATs, 3 of them had a daily average number of contracts which was more than 100;
 - more than 27.000 bonds were (and are) traded on the ATs; among these, about 25.000 were (and are) bonds issued by credit institutions, more than 1.000 were (and are) corporate bonds and almost 500 were (and are) government bonds.
 - bonds issued by credit institutions were (and are) for the most part (about 80%) traded on just one AT; many bonds issued by credit institutions were (and are) traded in less than 5 ATs; only few of these financial instruments were (and are) traded on more than 20 ATs
 - As a first step and on the basis of a self-assessment process, following MiFID implementations, Italian ATs had to decide how proceed in the operation and how to qualify themselves (entities operating MTFs if previously active as multilateral ATs and then wishing to ask for the authorisation; systematic internalisers if previously operating under the bilateral AT status and then satisfy the criteria set up by MiFID for systematic internalisers; or simply as investments firms operating on their own account on behalf of their clients). Furthermore, under the Italian legislation the multilateral ATs operated by regulated market operators automatically acquired the status of MTFs.
 - ***The results of the self-assessment carried out by investments firms previously operating ATs together with the transparency regime designed by Consob for non-equity markets provide the picture of the pre- and post-trade transparency information available to the public since March 31, 2008 (deadline fixed to take a decision on the future of operated ATs) on non-equity financial instruments.***
 - The decision to adopt a non-equity market transparency regime has carefully taken into account costs and benefits associated and the intention was to maintain the existing transparency level for bonds in order not to assist to a diminishing level of information

available as a result of MiFID “lack of regulatory intervention” in this area. Finally, a significant role has been played by the nature of investors participation to bond markets.

- ***On the other side, the approach in the definition of an adequate transparency regime for non-equity markets took also into account the potential risks involved for domestic intermediaries given the absence of an harmonised approach at European level in this area.*** In particular:
 - a) the risk of regulatory arbitrage;
 - b) the costs for intermediaries having to be compliant with additional requirements in the area of trading transparency.

- On such basis, ***the Italian current transparency regime on non-equities financial instruments is characterised by a flexible approach*** which does not prescribe specific transparency requirements of trading venues in terms of timing and content of information to be made available to the public. Furthermore, having regard to investment firms obligations, the regime focuses on post-trade transparency obligations and allows intermediaries to benefit (in terms of content and timing of obligations) from the “work” already done for transaction reporting purposes. In particular, Consob Regulation requires:
 - a) ***regulated markets, MTFs and systematic internalisers to set up and maintain a transparency regime for financial instruments traded on the systems operated by them. In other words, the approach focuses on market-led solutions,*** so that regulated markets, MTFs and systematic internalisers may design their transparency rules, specifically taking into account the market microstructure, the nature of the financial instrument, the amount traded and the type of market participants involved with specific attention to retail investors involvement;
 - b) ***investment firms to make post-trade transparency on transaction concluded outside regulated markets, MTFs and systematic internalisers on financial instruments other than shares admitted to trading on Italian regulated markets.*** Investment firms shall make public the information concerning the date and time of the transaction, the details of the financial instrument involved, price and quantity of the transaction concluded. The obligations apply to transactions below or equal to the amount of 0,5 million euro: for transactions exceeding such threshold investment firms are allowed not to show the quantity but simply an indication as to whether the transaction exceeds the threshold. In terms of timing, the information have to be published with reference to each transaction by the end of the working day following conclusion of the transaction.

- At this stage, ***21 intermediaries in Italy have communicated to Consob their nature of systematic internalisers on financial instruments other than shares.*** The information provided show that:

- they have different characteristics in terms of organisation arrangements, trading systems, frequency of trades concluded on the systems and commercial role of the activity performed;
 - the systematic internalisation activity is performed by large institutions as well as by small/medium size investment firms;
 - most of the systematic internalisers operate on shares issued by the bank or the group they belong and their clients have a retail nature;
 - some of the systematic internalisers (6 out of 21) operate on financial instruments other than their shares, such as bonds (corporate and government) and certificates, and their services are provided to institutional clients.
- In terms of business rationale behind the decision to become systematic internalisers on financial instruments other than shares, ***it appears that systematic internalisers have considered useful to gather together previous bilateral ATs in order to get and provide a higher quality service*** in terms of price formation and transparency characteristics. What appears different is the decision of systematic internalisers to trade on a more restricted number of bonds compared to the activity previously performed on bilateral ATs. Furthermore, a few number of new MTFs have been authorised to operate on financial instruments other than shares. ***One of the MTFs has been specifically created in order to gather together previous bilateral ATs.***
 - In general terms, regulated markets have maintained their standard of transparency. Furthermore, ***the level of transparency has not registered a reduction as a consequence of the self-regulatory regime for systematic internalisers and MTFs, since they have basically maintained the previous transparency standards required in Italy for bilateral and multilateral ATs.*** A certain level of pre trade transparency and delayed post trade transparency is actually made available to the public. Brokers are actively working to maintain a ***minimum level of post trade transparency also for financial instruments traded on the systems but not admitted to trading on regulated markets and, therefore, exclusively negotiated OTC.***

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- Discussion of structural differences between equities and bonds are often taken as first and important step to analyse the possibility to have a transparency regime for bonds. ***It is well recognised that markets for bonds and those for equities differ.*** But it should be noted that ***differences among bonds should be taken into account as well.***
- Although markets rarely suffers from greater transparency, ***transparency of trading information on complex product structures could be misleading*** and originate drawbacks in terms of information and signals provided to investors. In light of this, ***it might be of some value focusing the attention on whether market functioning could be enhanced and developed in terms of efficiency, new trading strategies and market participation, and what are the cost and benefits associated to a transparency regime that aims at reaching the above objectives.***

- The decision to extend transparency to financial instruments other than shares is considered by Consob as a first but important step towards transparency on bond markets. We are carefully monitoring (and will continue to monitor) the impact of the approach designed for the transparency regime in Italy. It is certainly crucial that any decision to go on or amend the regime in place is taken on the basis of the analysis also carried out by international fora together with a constant dialogue with market participants so that the result could represent an agreeable solution for the interested parties and the risk of regulatory arbitrage minimised.