THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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PUBLIC STATEMENT

The 17th meeting of the Market Participants Consultative Panel

The Market Participants Consultative Panel held its 17th meeting on 29 September 2008 in Paris.

The discussion was facilitated by the Vice Chair of CESR Carlos Tavares and covered: (1) developments in trading and post-trading in the EU and (2) a further discussion on the effects of the market turmoil, both in the EU and the US.

1. Developments in trading and post-trading in Europe

The discussion was introduced on the basis of two presentations, given by MPCP-members.

The first presentation on trading issues underlined the market impact of the MiFID which entered into force in November 2007. MiFID delivered its promise in more competition and improvement of services. Next to Regulated Markets, new initiatives such as Multilateral Trading Facilities (MTF's) and Systemic Internalisers have emerged. A number of Regulated Markets have launched or are in process launching their own MTF. A number of these trading platforms are now gaining market share. The number of Systemic Internalisers however remained below expectations so far. MiFID also delivered a number of unintended consequences such as: less integration, decreased transparency and confusion in trade reporting.
With regard to the US, the following major developments in the area of trading were perceived: an increase in electronic trading, direct market access and increased competition between broker/dealers and exchanges. Finally, it was noted that the links between the US and the EU have been strengthened by the mergers and take-overs of various US and EU trading platforms.

In the second presentation on post trading issues, it was noted that the establishment of the Code of Conduct served as a facilitator of requests for cross-border access by a number of infrastructure providers. Investment banks are now also entering the post trading arena with stakes in infrastructure providers. The Code of Conduct created a 'shotgun approach' for incumbents and offered scope for regulatory arbitrage by new CCP's, according to this presentation.

The Code only applies to cash equities and the Panel was reminded about the fact that the Monitoring Group for the Code of Conduct confirmed earlier this year that there was no reason to rush into other asset classes. Given that the Commission may consider expanding the scope to derivatives, it was strongly recommended to take the global situation into account. Hesitations also pertained to the fact that the market for derivatives is a very different market, compared to cash equities with different characteristics.

The final observation in this presentation was the creation of common platforms for settlement such as the T2S-project or the LinkUp Markets initiative. These initiatives may have a strong impact on the revenue base of CSDs. Based on experience in the US, it was emphasized that liquid markets (such as the market for government bonds) do not want to be served by a central utility. Prices for clearing and settlement of transactions at domestic level in the EU, are comparable with prices in the

US. The current bottlenecks in the EU are at the level of cross border transactions where public authorities need to do more to remove existing barriers, as identified in the Giovannini-reports.

In the discussion that followed after the presentations, one member of the MPCP was doubtful about the facilitating role of the Code of Conduct as it will not help to reduce the costs structure, according to this view. In this opinion it is not the individual cost structure of a single provider, but the duplication of costs in the clearing and settlement of cross border transactions. Consolidation among providers is a necessary condition to reduce costs. The key question is: how to reduce the number of CCP's and CSDs. CESR should pay more attention to the need for consolidation among CCPs. The discussion was ended with the conclusion that the push for improving the safety and soundness in post trading was more coming from the T2S-project.

2. Market turmoil

The discussion among Panel members on the ongoing market turmoil started with an overview of various issues related to the (first) Paulson plan in the US. Market responses so far have been doubtful about the capability of the Plan to solve the crisis. Timing of the plan was considered unfortunate, due to the upcoming elections in the US. The initial lack of any accountability vis-à-vis the US Congress was not helpful for finding agreement on the approval of the Plan. The reversed auction-method in the Plan would however offer government an upside for the sale of assets involved. One member underlined the dilemma in the execution of the Plan: purchases of assets above a market price would be considered as a subsidy for banks, purchases of assets below market prices would not help the banks. This member hold the view that the best way forward would be to start buying assets of good quality in order to get the market re-started again. Additionally, the crisis coincided with a number of open questions such as: the bigger role of bank holdings, unfair criticism towards the chairman of the SEC and doubts about the sustainability of the securitization model. A first lesson to be learned was the reality that some firms are larger than the regulator involved.

In the discussion that followed, members of the MPCP touched upon the lack of transparency for some financial products, the massive destruction of wealth which took place in the past weeks and months and (in an EU context) the paradox between local banking supervision and the level of lending of last resort function at the level of the ECB. Another member held the view that no lesson has been learned so far, criticising the lack of effective supervision in the US with regard to mortgage advisors and the credit card business, the bankruptcy of the model for investment banking and the importance of governments now taking the lead to solve this crisis of confidence. In comparison, this member assumed that the European model might be more resilient, due to a better balance of risks.

Another member noted that trust is the basis for operation in the financial services industry. Rapid reactions of authorities are required to address the liquidity problem with a view to avoid fire sales and in order to avoid that a liquidity problem might turn into a solvency problem. A third observation by this member is the importance to distinguish between public and private interests. Those who are responsible need to be identified, but now is the time 'to save the building' before further problems will be passed on to the real economy. Finally, accounting rules may be an area to look into.

Upon request, members focused explicitly on future ways forward. Some members of the Panel took the position that it is time to review the supervisory structure in Europe, given the current fragmentation of it. In this context, reference was made to the notion of 'big fishes in small markets'. On the other hand, the focus of MiFID has been nearly entirely on competition at the expense of liquidity, transparency and counterparty risk. Under the present circumstances, it would be useful to revisit the assessment of the MiFID and the Financial Services Action Plan in general. Another member underlined the importance of sound risk-management by supervised firms and a good understanding of regulators of the portfolio's held by supervised entities. The response to the crisis would not necessarily be: more regulation, but might be found in a different approach, more focused on systemic risks.

A re-think was promoted about the funding of (national organised) compensation schemes in case of defaults. Another member underlined the need to explore support for the establishment of a European equivalent for the Paulson plan, i.e. a fund to buy out toxic assets in Europe. It was noted that this might lead to a solidarity problem, assuming country A is not willing to fund compensation for a defaulted firm in country B.

One member underlined the useful role hedge funds fulfil in buying non-wanted assets from other players in the sector. Current market circumstances put these hedge funds really to the test, given their demanding performance standards. In this view, the public and private sector need to cooperate to improve the ways the industry operates. For this reason, there should remain room for self-regulatory initiatives. The European hedge funds industry was able to agree on a set of standards with regard to: transparency, risk management, conflicts of interest, (third party) valuation, governance and activism. A similar initiative in the US did not made progress so far, in particular due to differences of view on valuation and governance.

In the context of cooperation among regulators, members of the MPCP discussed the recent bans on short selling. They noted that little evidence was given to support these measures. Members warned for unintended consequences such as: the impact on hedging strategies, the freeze of the convertible bonds market, the shift in focus to firms not impacted by the bans and destabilizing effects of disclosure. The discussion was concluded with a call for a dialogue between industry and regulators to help formulating appropriate regulatory responses.

Due to time constraints, the discussion on the mandate for mutual recognition was postponed and the MPCP-members were invited to give their views on CESR's Work Program for 2009 in a written procedure.

3. Future meetings

- Paris, 11 December 2008 (jointly with CESR Members)