



The UK Society of Investment Professionals

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4th Floor, 90 Basinghall Street
London EC2V 5AY

Tel +44 (0)20 7796 3000

Fax +44 (0)20 7796 3333

Email uksipstaff@uksip.org

www.uksip.org

Mr Tim Rowe
Markets Policy
Financial Services Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Dear Mr Rowe

DP 05/5 Trading transparency in the UK secondary bond markets

UKSIP welcomes the opportunity to respond to the issues raised in the discussion paper: Trading transparency in the UK secondary bond markets and would recommend that a meeting be held with yourselves to discuss a number of technical matters relating to the bond market. The Society believes that such a meeting would help considerably to inform the debate.

The Society acknowledges that the bond markets - and, in particular, the eurobond market, have expanded massively since the introduction of the euro. It does not, however, believe that there is a need for further regulation in the secondary UK sterling market as, in its view, there is no market failure in respect of transparency and price setting. Although the market has become more institutionalised this, in UKSIP's view, does not represent a market failure; rather the market's success has, by default, reduced participation by retail investors. Clearly, the expansion in the market has been driven by investors as well as issuers. Corporate issuers have increasingly viewed the eurobond market as an attractive core funding source as the introduction of the euro has provided access to investors across borders. At the same time large players, primarily insurance companies, banks and pension funds, are viewing European credit as a core asset class for investment portfolios. The sterling market, while remaining important, has become a specialised sub-sector of the broader euro corporate bond market. These trends are likely to continue resulting in direct investment by retail investors taking an increasingly smaller share of these markets.

These dynamics mean that each trade in this market tends to be for a very large sum which would be beyond the purse of virtually all private individuals. Economies of scale, therefore, have a role to play because - whilst individuals can trade smaller amounts - the bid/offer price will be less attractive than for larger sums. Individuals are, therefore, almost certain to achieve best execution by going through an intermediary. The larger volume of retail trading in other countries is attributable to products designed for the retail sector, such as mortgage bonds in Denmark. These are, however, legacy markets which will gradually disappear. Indeed, the case of Parmalat shows that, even where a retail market flourishes, direct retail investors can be particularly badly affected when a problem arises, resulting from the asymmetry in knowledge and the ability to react to a

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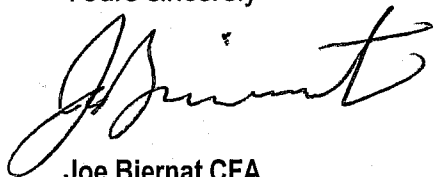
change in circumstances. In UKSIP's view, therefore, limited direct participation by retail investors has arisen from inherent market fundamentals rather than market failures adversely affecting this group of investors.

In addition to the above, UKSIP believes that neither the wholesale nor retail market is affected by a market failure caused by either inefficiency in the price formation process or a failure of best execution. It is true that when the market was initially developing, pricing information was poor. However, since those early days, the market has devised its own pragmatic solutions which, although not perfect, are suitable for most participants. Examples of these include the development of the credit default swap market (CDS). In fact, the CDS market is becoming the most liquid sector of the credit markets due to the introduction of standardised documentation and settlement procedures that facilitate trades. Indices based on baskets of individual CDS such as the iTraxx indices have become standard tools for measuring and hedging credit risk in the institutional market. It is worth noting that due to the complexity of the operation of the CDS market and the fact that pricing information is only generally available to institutional participants, there is no place for the direct participation of retail investors in this market. The costs of changing trading practices in the CDS market to accommodate retail investors would be likely to have a significant adverse effect on the wholesale market to the detriment of millions of indirect investors via pension and other funds. With regard to the government bond market which tends to be more liquid than the credit market transparency is less of an issue as it had until recently developed a more actively traded class of associated derivatives.

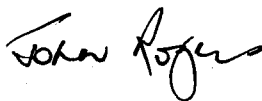
Given that the secondary bond market is, and is likely to remain, a professional market which has proved itself able to find workable solutions to problems that have arisen, UKSIP considers that there is little need to introduce additional regulation. The Society does, however, recognise that continuing high standards will be threatened if the level of professional expertise of those operating in the market fails to be maintained. UKSIP is, therefore, concerned that the proposals contained in the FSA's consultation paper 05/10 - Reviewing the FSA Handbook - to abolish the requirement for those operating in the so-called wholesale market to pass benchmark entry level qualifications and to be regulated as an approved person. Such weakening of requirements is likely to reduce the level of professionalism and competence and, thereby, adversely affect technical and ethical standards in the bond market. (UKSIP's response to this recent FSA paper is enclosed for your information.)

As mentioned at the beginning of the letter, UKSIP would welcome the opportunity to discuss the issues surrounding both the secondary and primary bond markets. Please contact my colleague, Tracy Blake (tracy@uksip.org 020 7776 7519) to arrange a mutually convenient appointment.

Yours sincerely



Joe Biernat CFA
Chairman UKSIP Bond Committee



J E Rogers
Chief Executive

Enclosure

About UKSIP

The UK Society of Investment Professionals ("UKSIP") is a professional organisation whose main aim is to foster and maintain high standards of professional ability and practice in investment analysis, portfolio management and related disciplines. UKSIP currently has nearly 6000 members who work or have an interest in the UK financial services industry. Most members hold the ASIP, CFA or IMC designation. The ASIP designation is held primarily by those who successfully completed UKSIP's former Associate examination, which was similar to the CFA. UKSIP is the UK-based member society of the CFA Institute, the organisation that develops and administers the Chartered Financial Analyst (CFA®) Program.

UKSIP also develops and administers the Investment Management Certificate (IMC), the benchmark qualification for those working in investment management in the UK. Over 15,000 investment professionals have passed the IMC.