



**CESR TECHNICAL ADVICE TO THE EUROPEAN COMMISSION IN THE CONTEXT OF
THE MIFID REVIEW: NON-EQUITY MARKETS TRANSPARENCY**

A response by the Futures and Options Association

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1. Introduction

- 1.1. The Futures and Options Association (FOA) is the industry association for more than 170 firms and institutions which engage in derivatives business, particularly in relation to exchange-traded transactions, and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector.
- 1.2. This FOA response is intended to supplement and not to supersede any responses submitted by individual member firms. While comments in this paper represent the agreed position of numerous contributors, individual firms may have different views on specific issues. Furthermore, the FOA has reviewed the joint association response prepared by AFME/BBA/ISDA and supports the views expressed within that.
- 1.3. The FOA is responding only to the sections of the consultation and the individual questions which concern derivative markets.

2. General points

- 2.1. Direct retail participation in derivative markets is relatively limited. Consequently, evaluation of existing transparency and measures intended to increase transparency should take into full account the resources, concerns and needs of professional, wholesale market participants.
- 2.2. The CESR consultation groups interest rate, equity, commodity and foreign exchange derivatives together, but in practice the differences between these classes are significant, and even within a broader derivative class there can be considerable differences between specific assets. For example, power, oil, metals and soft commodity markets are all subject to different concerns arising from the nature of the underlying physical asset and the ways in which the physical assets are stored, transported and used. As the Commission recognised in its 2009 Paper on derivatives, it is necessary to “take into account the specificities of certain commodity contracts (e.g. electricity and gas markets).”
- 2.3. The FOA would recommend further detailed consultation on specific derivative markets before any legislation is introduced, and would stress the very real need for market specific regulation rather than a broad scope “one size fits all” approach which may not address relevant market issues.
- 2.4. The FOA supports the current move towards establishing trade repositories to collate trade data and facilitate the dissemination of that data to regulators. Trade repositories should be organised on an international basis, ideally with a single repository per asset class, with access to regulators being largely unrestricted, unless data security concerns exist around a given regulator and there is a legitimate concern that privileged trade data intended for regulatory use may be accessed by other market participants.

- 2.5. Data held within trade repositories should not generally be made available to the public other than at a high aggregate level.
- 2.6. The FOA recognises the need for adequate pre and post trade transparency, and believes that, where post trade transparency is adequate and both regulators and market participants have access to appropriate information for trading and market monitoring purposes, the venue for bilateral trades need not be a concern. The need to ensure market stability notwithstanding, where post trade transparency is deemed adequate, we believe that there is no justification to mandate exchange trading and central clearing of bilateral contracts.

3. **Specific questions**

Q1: On the basis of your experience, could you please describe the sources of pre- and post-trade information that you use in your regular activity for each of the instruments within the scope of this consultation paper.

- 3.1. Pre-trade transparency is available through a variety of brokers, dealers, information services with sources varying by underlying asset. Specific sources of transparency by market are as follows:
- 3.2. Interest rate derivatives:

Pre trade

- Bloomberg and TradeWeb live trading platforms providing competitive Request for Quote (RFQ) and single dealer execution services;
- Bloomberg and Reuters provision of live trading data to clients and data on benchmark instruments via broker screens; and
- Assorted single dealer proprietary platforms.
- Market infrastructure exists to provide timely trade affirmation and execution level information;
- Inter-dealer trades executed by brokers are widely reported to the market where data is not deemed sensitive;
- Dealer information on client positions provided as part of the service; and
- End-of-day price data and mark-to-market position revaluations available to clients via CCPs.

Post trade

- Market infrastructure exists to provide timely trade affirmation and execution level information;
- Inter-dealer trades executed by brokers are widely reported to the market where data is not deemed sensitive;

- Dealer information on client positions provided as part of the service; and
- End-of-day price data and mark-to-market position revaluations available to clients via CCPs.

3.3. Equity derivatives:

Pre trade

- Broker and dealer quotes;
- Market information from Bloomberg and other vendor tools; and
- In-house pricing tools for hedging activity.

Post trade

- Discussion with dealers, brokers and clients.

3.4. Commodity derivatives:

Pre trade

- Inter-dealer brokers;
- Electronic exchanges (e.g. ICE, APX, LME, Powernext and Nordpool);
- Electronic broker platforms;
- Voice brokerage services; and
- Newswire based platforms (e.g. Bloomberg, Reuters).

Post trade

- Clearing houses focused on specific commodities, including CME Clearport (softs, base and precious metals, crude oil, oil products, gas, weather), ICEClear US (softs, crude oil, oil products, emissions), LCH (base and precious metals, plastic, freight), NOS Clearing (emissions, freight) European Commodities Clearing (emissions, gas, power) and APX (gas, power);
- Dealers may use electronic matching platforms (although these include physical and financial commodity data).

3.5. Foreign exchange derivatives:

Pre trade

- Market data providers (Bloomberg, Reuters);
- Broker screens;
- Exchange data;

- Direct bank and market maker services, often providing more detailed functionality than general platforms; and
- Individual service providers such as aggregators acting as principles, who combine the best prices and may provide better prices than banks.

Firms note that given the highly bespoke nature of FX options (variable strike prices, barrier levels, maturity dates, etc), there are not generally any direct price comparisons available, although clients have access to the necessary pricing inputs (spot rates, forward rates, etc) to model pricing comparisons.

Post trade

- Several sources as noted above (broker screens, market data providers, exchanges) provide post trade data; and
- Data provided to CLS.

- 3.6. As noted above, the broad derivative classes covered by this consultation contain within them many individual assets. A comprehensive study of available sources of pre and post-trade transparency would require a more specific derivative market consultation.

Q34: On the basis of your experience have you perceived a lack of pre-trade transparency in terms of access to pre-trade information on a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives, and the content of the information regarding these products available in the market?

- 3.7. Member firms reported no areas where there was a lack of pre-trade transparency for exchange traded derivatives in any of the specified classes.

Q35: Is pre-trade transparency readily available to all potential markets participants?

- 3.8. As noted above, market participants are almost exclusively professional, wholesale clients with access to the various information sources identified in Q1. No exceptions were noted by member firms.

Q36: Is the pre-trade information currently available in these markets consolidated and effectively disseminated to those market participants who make use of it? If necessary, please specify your answer by product.

- 3.9. In most cases, market participants are able to access data and consolidate where necessary, with some service providers allowing participants to customise data streams to suit their requirements.
- 3.10. Some firms noted that **equity** derivative markets lack a source of consolidated data, with individual dealers providing information using their own mechanisms to clients and other dealers. At present a number of software vendors are understood to be looking at developing products to enable to consolidation of pre-trade information from multiple dealers.

Q37: Which potential benefits and drawbacks of a pre-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.

- 3.11. Firms note that **interest rate** derivatives already benefit from high levels of pre-trade transparency. The concern is that greater levels of transparency still may discourage firms from acting as market makers if certain products are subject to a more extensive pre-trade transparency regime which may prove onerous or deter end-use participation.
- 3.12. Firms note that it is difficult to generalise about the impact of increased pre-trade liquidity on non-vanilla **equity** derivative products. For vanilla products, increased pre-trade transparency is likely to make initial requests for quotations simpler, and make markets more generally accessible with a resulting increase in trading volume. Excessive transparency in some markets may, however, result in reduced liquidity where disclosure of certain features (e.g. the leverage requirements for synthetic prime brokerage) is deemed undesirable.
- 3.13. **Commodity** market participants, particularly industrial end-users, are concerned that significant changes to transparency may result in markets moving against posted bids or offers. Liquidity may therefore suffer as some end-users reduce their participation. This may have additional consequences for risk management capability and cost, particularly in the smaller more specialist markets.
- 3.14. **FX** markets are considered extremely transparent already and no advantages or disadvantages were noted.

Q38: Do you believe that pre-trade transparency would be desirable for some or all types of OTC derivatives (i.e. equity, interest rate, forex and commodity derivatives)? Which key components should a pre-trade transparency framework for any of these above mentioned derivatives have? Which pre-trade information should be disclosed?

- 3.15. **Interest rate** and **FX** OTC derivatives are seen as adequately transparent. While some improvements in **interest rate** transparency might be possible, no particular demand for such was expressed by firms. **FX** OTC arrangements are viewed by firms as being too bespoke to benefit easily from changes to pre-trade transparency.
- 3.16. OTC **Equity** contracts were identified by firms as being most in need of increased pre-trade transparency. An improved framework might include the provision of an electronic platform together with the ability for firms to execute entire orders without them being broken up. Specific information would very depending on the product, but should generally include maturity, strike price, size and currency.
- 3.17. **Commodity** markets were not identified as suffering from a lack of transparency for OTC contracts. Market participants are generally able to access available information and end-users are generally understood to be concerned that the recognised dangers of greater transparency outweigh the more nebulous benefits.

Q39: On the basis of your experience have you perceived a lack of post-trade transparency, both in terms of access to relevant information and the content of this information for any of the following markets: a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives?

- 3.18. Responding firms did not believe that there was a lack of post-trade transparency for either **interest rate** or **commodity** derivative markets.
- 3.19. Firms noted a lack of transparency for OTC **equity** derivatives due to the lack of a central post-trade reporting mechanism.
- 3.20. Although post-trade transparency for **FX** derivatives is currently less extensive than pre-trade, an industry lead initiative to provide market participants and regulators alike with increased post-trade data is already underway. CLS Bank is developing a central repository for post-trade **FX** data. Further changes to post-trade transparency should wait until the impact of this repository is understood.

Q40: Do you believe that additional post-trade transparency would be desirable for all of the above instruments? If not, which ones would benefit from greater post-trade transparency?

- 3.21. No additional post-trade transparency is required for **interest rate** derivatives.
- 3.22. The concerns expressed above regarding pre-trade transparency for **commodity** derivatives apply even more so to post-trade data. Large corporate end-users are at risk of having privileged information made discernable if post-trade data becomes more freely available.
- 3.23. Firms note that certain **equity** derivatives would benefit from increased post-trade transparency, including equity options, dividend swaps and variance swaps.
- 3.24. See Q39 above for **FX** derivatives..

Q41: Is post-trade transparency readily available to all potential market participants? Does this vary by asset class?

- 3.25. Sufficient post trade data is deemed readily available for participants in **interest rate** and **commodity** derivative markets.
- 3.26. Firms are of the view that insufficient post-trade transparency exists for OTC **equity** markets.
- 3.27. See Q39 above for **FX** derivatives.

Q42: Which potential benefits and drawbacks of a post-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.

- 3.28. Given the current level of post-trade transparency in **interest rate** derivative markets, firms do not feel that additional transparency would yield appreciable benefits. Potential drawbacks would include the increased cost of reporting without

commensurate benefits, and subsequent reductions in market participation, liquidity and similar, with resulting increased costs for remaining participants.

- 3.29. Increased post-trade transparency is likely to result in some increase of volume within **equity** markets arising as a consequence of enhanced confidence. Some firms caution that information may give rise to market distortions if the motivation for certain transactions is misunderstood. For example, bespoke transactions regarding a limited number of equities intended to hedge a specific risk could undermine confidence in those companies, or indeed larger market sectors if the motive for the original transaction is not known.
- 3.30. Conversely, in situations where the motive for bespoke **equity** transactions is known, or can be easily ascertained, the additional transparency could enable competitors to more easily anticipate future transactions by market participants. As with other markets, the fear that increased transparency could expose a firm to a degree of competitive disadvantage could result in reduced liquidity.
- 3.31. As noted previously, large end-users of **commodity** markets have expressed a similar concern to that noted for equity markets above, that post-trade transparency could reveal privileged information to observers. Granting access to detailed information to regulators only, and making aggregate market movements available to the broader market may go some way to mitigating this risk, but even this may be insufficient for markets utilised by a small number of large industrial end-users, as large aggregate movements may be easily linked to specific firms. Firms generally express the view that the risks exceed the advantages to be gained from increased post-trade transparency.
- 3.32. See Q39 above for FX derivatives.

Q43: Which are the key components (e.g. qualitative or quantitative criteria) which should be taken into consideration when designing such a post-trade transparency framework?

- 3.33. For all four identified derivative classes, the impact of changes on liquidity is a prime concern. Confidentiality, and the associated confidence of market participants, is also of significance, in particular for **commodity** markets, with a loss of confidence giving rise to concerns over liquidity.
- 3.34. Given the high level of transparency already present in most of the identified derivative markets, firms are concerned over the potential cost in time and resources of any new regime compared with the limited benefits it might produce. As noted above, any further recommendations for pre or post trade transparency should be subject to more focused review to ensure appropriateness for the specific asset.

Q44: Do you think that a post-transparency regime could have some additional valuable externalities in terms of valuation, risk measurement and management, comparability and other uses in price discovering process on related underlying reference instruments?

3.35. Only in the case of **equity** derivatives did firms identify the potential for additional beneficial externalities.