Comments by the London Investment Banking Association (LIBA) on CESR's Consultative Concept Paper on transaction reporting and co-operation and exchange of information between competent authorities (Ref: CESR/04-073b)

1. The London Investment Banking Association (LIBA) represents the major international investment banks which base their European operations in London. A list of our Members is attached.

Summary of LIBA's response: Guiding principles of CESR's approach to advice on Article 25

2. We suggest that the following guiding principles should underlie CESR's approach to its advice in this area:

   - Before designing transaction reporting arrangements and procedures, CESR should specify precisely how it thinks that transaction reports would be used in practice.
   - CESR should not have an unrealistically ambitious vision of the uses to which transaction reports can be put.
   - CESR should not seek to duplicate or supersede market surveillance functions which are currently performed effectively by regulated markets.
   - Given the permissive nature of Article 25's comitology provisions, CESR should give preference to Level 3 solutions over Level 2 solutions, in particular as regards information exchange between regulators.
   - Firms must be able to discharge their transaction reporting obligation with a single report.
   - Any disruption to existing transaction reporting systems must be carefully considered and justified on cost-benefit grounds.
   - The regulatory structure should not impede the development of streamlined trade and transaction reporting and settlement instruction arrangements, and should take account of the wider international dimension of securities business.
   - The minimum content of transaction reports should include only information which is required for transaction analysis.
   - Transaction reports need not include information which is already known to the authorities or information which can be gathered as part of a more detailed investigation.
   - The 'relevant market in terms of liquidity' concept does not fit easily with modern market structures and the single European market; it should not be allowed to have the effect of constraining them.
   - Exchange of transaction reporting information between competent authorities should be a matter for the competent authorities to arrange between themselves. However, existing safeguards for firms should be preserved.

Comments on CESR's Consultative Concept Paper

A. Foreword

3. As we stated in our evidence on the Commission's draft mandates, we welcome CESR's decision to collect comments from market participants with respect to issues covered by the Expert Group on Co-operation and Enforcement at an early stage, before CESR publishes its consultation paper in June 2004. We consider that it is of particular value to CESR to give participants in the market the opportunity to contribute technical advice at such an early stage.

4. The Consultative Concept Paper outlines the preparatory work undertaken by the CESR Expert Group on Co-operation and Enforcement, including two surveys regarding the way competent authorities currently receive transaction reports and the content of these reports. We recommend that CESR release these surveys in order to maximise the value of the input that industry participants are able to provide.

B.2.1 Objectives

5. It is essential that the transaction reporting regime is tailored to what it can realistically deliver. While CESR has set out its broad objectives, it has not offered its thoughts on how the information will be used by competent authorities, the relationship of those authorities to the regulated markets which also use this information, the cost-effective benefits, and how the resulting arrangements would be financed. We would ask CESR to explain the cost-effective benefits of its advice on transaction reporting in the context of the comments in paragraphs 6 to 8 below on the functions which CESR foresees that transaction reporting could fulfil.

6. CESR outlines the objectives of transaction reporting, and states that it is an essential tool in the detection, investigation and enforcement of anti-market-abuse provisions. We would argue that this is not always the case. The huge volume of data can make the detection of market abuse via transaction reports more difficult. We would ask CESR to review the effectiveness of the previous nine years of transaction reporting in order to give a clearer view of how it envisages transaction reports being used for this purpose. It would also be valuable to analyse the contribution of the current transaction reporting regimes to the prosecution process.

7. Furthermore, we do not think that transaction reporting to regulatory authorities should be treated as the exclusive or primary means of assessing whether trading venues are functioning in an orderly manner. The responsibility for the orderly functioning of its market lies with the trading venue itself, supervised by the competent authority. Competent authorities should not seek to duplicate functions which are already performed by regulated markets.

8. Further, we doubt that objectives such as the detection of money laundering can be facilitated through transaction reporting as envisaged.

B.2.2 Methods and arrangements for reporting financial transactions

9. The general principle of transaction reporting should be that investment firms need report once only, either directly to the competent authority or through an accepted alternative reporting arrangement. Competent authorities should not unreasonably withold approval for reporting through alternative arrangements. Competent authorities should have the responsibility for setting the standards in their own jurisdiction as to the technical aspects of alternative arrangements.

10. If Members of CESR believe that some harmonisation of technical arrangements is appropriate, CESR should first consider doing so at Level 3 rather than Level 2, bearing in mind that Article 25.7 is permissive, not mandatory. In any event, CESR should justify any such harmonisation by demonstrating the business benefits.

11. With regard to the provisions of Article 25.5 outlining the reports of transactions to be made to the competent authority, we consider that the Concept Paper makes a fundamental category mistake with regard to the reporting obligations. The obligation to report applies to the investment firm itself. The remaining bullets in paragraph 2.2 merely identify the means through which the obligation can be met if the firm does not report to the regulator directly. It is important that any requirements that CESR proposes ensure that regulators retain the power to exercise flexibility as regards the mechanism that firms use to discharge the reporting obligation. It is also important explicitly to set out how the obligation to report is extinguished.

12. In the Consultative Concept Paper CESR considers the possibility of drawing up an inventory of minimum conditions with which systems would have to comply if they are to be considered valid to report transactions to the competent authorities. However, the danger with an inventory of minimum conditions is that it is too specific and as a result can be inflexible and unable to adapt to future market developments. A more effective method of providing technical advice, which can be forward-looking and take account of future market developments, would be to produce a business description of an adequate system with a number of functional requirements which ensure (a) that firms can deliver the required transaction reports, (b) that the system is secure and data integrity is preserved, and (c) that regulators can read the output provided to them by the firms. Such a business description would not prescribe the precise technologies to be used.

13. It is important that affected firms are given the necessary time to implement any new requirements. It should be noted that, in principle, savings on development costs can be made where longer implementation timetables are provided because there is greater scope for the work to be taken forward in parallel with the work on systems updates which firms will be undertaking in any case. CESR should note that transaction reporting sub-systems in firms are intimately connected to major production systems, responsible among other things for position keeping and clearing and settlement. Firms typically exercise great care in modifying such systems and a careful approach takes time.

14. We welcome CESR's intention to take into account the potential overlaps between information required by Article 25 and under post-trade transparency requirements, and to explore ways in which commonalities between the two can be exploited to avoid unnecessary duplication and costs for both regulators and the industry. CESR should take full account of the interaction between messaging formats for trade reporting, transaction reporting, and settlement instructions. It should take account of work which is already being done by various industry bodies to identify useful standards that are compatible with consolidated reporting solutions and straight-through processing. It should also take account of the wider international dimension of securities markets. CESR must not try to develop its own solution independently of this work, and not mandate unsuitable standards for security identifiers.

15. We welcome the fact that CESR is considering the existing arrangements for transaction reporting as a working basis and will seek to refrain from imposing unwarranted new requirements, which would involve radical changes to the existing arrangements and bring about excessive additional costs. However, we disagree with the implication that these considerations might be overridden by the fact that "CESR is required to respond to the Mandates appropriately so that the arrangements are effective". There should be an overriding requirement for CESR to be able to justify any additional costs that would be imposed on industry participants. CESR should have particular regard in this context to the fact that the comitology provisions in Article 25 are permissive, not mandatory. This means that CESR should not recommend any implementation measures at all without providing clear evidence that the costs are justified. Further, the concept of 'effectiveness' contains within it the concept of 'cost-effectiveness'. Given the permissive nature of the comitology provisions, CESR should also take full account of the scope for regulatory cooperation at Level 3 as an alternative to legislation.

<u>B.2.3. The criteria for assessing liquidity in order to define a relevant market in terms of liquidity for financial instruments</u>

16. Given the practical complexities that arise from the concept of 'relevant market in terms of liquidity' (see paragraphs 18-20 below) CESR needs to define its policy objectives in relation to this provision before it designs a system for information exchange. If the goal is to enable the 'most relevant market' to use the information about trades on 'other' markets for surveillance purposes, it will be important to ascertain whether this aim can be more effectively achieved by leaving it to the markets themselves to exchange this information. If operators of markets themselves are currently exchanging this information, CESR would need to ascertain what the exchange of information between competent authorities would add. The fact that comitology provisions in Article 25 are not necessary to enable the Directive to take effect provides time to devise an appropriate solution.

17. In any event, it is essential that the second subparagraph of Article 25.3 applies communication obligations only between competent authorities, and does not force investment firms to make duplicated reports. The key message is that our member firms wish to avoid having to report transactions more than once. Further, current requirements to report the same transaction using different

configurations to different organisations are inefficient and resource intensive. CESR should seek a solution whereby firms are only required to report their transactions once, so that firms continue to have a choice as to where they report. In this context we welcome CESR's statement that 'It is not the intention of CESR that such arrangements established between competent authorities…would impose any additional obligations or burden on investment firms with respect to their reporting obligations'.

18. The concept of a "relevant market in terms of liquidity" suffers from a number of practical problems. First, should the relevant market be the single European market, or a particular national model? Trends in exchange competition suggest the former, but current structures suggest the latter. We believe that CESR's role is to deliver advice which can be used to support a single European securities market. Second, the concept of a relevant market as set out in the paper does not take into account remote membership. The ability for an investment firm based in one Member State to access markets elsewhere in the Union lies at the heart of the single market vision.

19. The concept of a "relevant of market in terms of liquidity" also does not take account of the fact that the liquidity may well shift from one jurisdiction to another. Nor does it take account of the practical difficulty of establishing a network for disseminating information between twenty-five competent authorities. Similarly, liquidity as a concept can no longer be considered to be anchored in space. Liquidity only exists as the revealed preferences of investors based all over the world. Therefore, conceptually trying to anchor liquidity to a particular location will not work.

20. There are a number of different possible criteria for determining which competent authority is most appropriate to receive and collate transaction reports. For example, reporting could be on the basis of the home country of the firm, the country of origin of a branch, country of nationality of the security or the location of the exchange where the security is admitted to trading (though some exchanges span more than one Member State). Furthermore, Article 25 implies that, when an investment firm reports through a regulated market or MTF, the exchange/MTF itself has an obligation to report to the home competent authority of investment firms that are remote members. There is no simple means of reconciling these different possibilities with firms' needs for a straightforward means of discharging their reporting obligations. In the interests of simplicity it may be necessary simply to deem a market to be a "relevant market in terms of liquidity", e.g. the market with the greatest on-exchange turnover, or the home market of the issuer. OTC business could be deemed to be located where firms have chosen to report trades under Article 26. We recommend that CESR should liaise very closely with market participants in order to develop the most appropriate solutions.

21. For the reasons given in paragraph 15 above, LIBA Members generally believe that CESR should not try to impose a single repository for transaction data at this stage. Any move towards a central repository would need careful further thought before winning the support of the market, however desirable in principle it may be thought to be.

B.2.4 The minimum content and the common standard or format of the reports to facilitate their exchange between competent authorities

22. These provisions raise two interconnected issues. The first relates to the need for reports to be in a common format. The 'common format' requirement relates both to the structure of the report and to the content of particular sections or 'fields' within the structure. The appropriate minimum information will depend on the purposes for which transaction information is used. For surveillance purposes the minimum content is likely to be that listed in Article 25.4: a means of identifying the instrument, size, price, time, identity of firm. Other data, which may be useful in the context of an investigation, but which is not necessary for initial processing of transaction reports, should not be required to be routinely reported. As regards the identity of the investment firm, it should be noted that there is no universal shorthand for identifying investment firms. While there are a number of global standardised codes for the identification of shares and individual issues of bonds, for derivatives and other OTC or bespoke financial instruments there is less standardisation. We urge CESR to engage relevant trade bodies in detailed dialogue to identify appropriate structures and content.

23. The second issue relates to the Directive's introduction of new gateway arrangements in place of existing arrangements. It will be vital to ensure that the new arrangements provide equivalent safeguards for investment firms and that there is appropriate independent oversight of the way in which those arrangements operate.

London Investment Banking Association (LIBA)
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