CESR: Call for Evidence on the Review of the Scope of the MiFID Transaction Reporting Obligation (CESR / 08-873)

A response by the
Futures and Options Association

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1 Introduction

The Futures and Options Association (FOA) is the industry association for some 170 international firms and institutions which engage in the carrying on of derivatives business, particularly in relation to exchange-traded transactions. The FOA's 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.

The FOA welcomes the opportunity to provide input to the Committee of European Securities Regulators' (CESR's) forthcoming review of the scope of the Markets in Financial Instruments Directive (MiFID) transaction reporting obligation. As discussed, we are aware that this is late submission but trust that CESR will, particularly given the short (five-week) consultation period, endeavour to take our views into account.

In this response, we have focussed on the questions raised by CESR in their Call for Evidence. In doing so, we have been mindful of the detailed joint industry feedback provided by BBA, ICMA, Xtraker and LIBA, which, in general, we support. The FOA's additional comments are, however, set out below.

2 Response to Q1

Have the differences in the scope if the transaction reporting obligation between CESR Members caused problems for you? Please provide practical examples of any difficulties encountered.

The transaction reporting obligation, as set out in Article 25 of the MiFID Level 1 Directive, gives rise, as we see it, to two main scope "issues":

Firstly, Article 25(3) requires "investment firms which execute transactions…" to transaction report. The term "execute" is not, however, defined and is, therefore, capable of different interpretations across the Member States (e.g. is it the "market-facing" firm or a firm giving orders for execution, whether to a market or another firm?). We are aware that this difference in scope is particularly problematic in the fund management sector.

Secondly, the transaction reporting obligation in Article 25(3) applies to "any financial instruments admitted to trading on a regulated market." Unfortunately, however, absent a central, CESR list, of all financial instruments (including on-exchange derivative contracts) admitted to trading on regulated markets, firms or their IT providers have to refer to each regulated markets on which they trade to obtain details of the instruments and their AII/ ISIN numbers and compile their own lists. There is, therefore, a risk, albeit small, that a firm's competent authority will be working from a different list. The FOA urges CESR to improve the transparency of information in this area.

As CESR is aware, a number of competent authorities have used their discretion under Article 13(4) of the Level 2 Implementation Regulation to MiFID to require that transaction reports identify the clients on whose behalf a firm has executed a transaction. Whilst the FOA appreciates that this information is of particular importance to these competent authorities for market abuse monitoring purposes,

firms with reporting obligations to more than one competent authority, have cited this difference in scope as a particular problem e.g. assumptions that firms codify into their transaction reporting programmes for their home Member State may not be valid for branches reporting to host state competent authorities. Also, as discussed in response to Q2 below, the requirement to report client-side information has also highlighted issues in respect of the transaction reporting of on-exchange derivative "give-up" business, which need to be clarified at an EU level.

In addition, where the competent authorities to which a firm and its branches report all require client-side transaction reports, we understand that different approaches are taken in respect of the client identifier referred in Table 2 of Annex I to the Level 2 Regulation.

Clearly, for firms providing services in more than one Member State, any differences in scope will be costly and may result in increased legal/regulatory risk. Hence, given that transaction reporting is a high-volume, systematic/ automated process, the FOA – notwithstanding its position on the need for EU Directives to allow Member States (where appropriate) flexibility in implementation – urges CESR, in the interests of ensuring a level playing field and uniform standards, to encourage all competent authorities to implement a consistent approach towards transaction reporting and, in particular, client side reporting.

3 Response to Q2

Please provide information on your practical experience in reporting transaction that fall under each of the items (a) – (c) above? Is the difference between these three categories sufficiently clear? Do the competent authorities interpret the scope of these categories in the same way? If not, where in particular you have encountered problems?

We have the following comments in relation to items (a) and (c):

(a) Information relating to transactions conducted by the investment firms transacting directly with an execution venue (immediate market facing firm)

The FOA does **not** believe that there is a unified approach across the EU to determining the location of execution for electronic trading, although we have had very helpful discussions with the FSA on this point.

If a firm has direct market access (DMA) clients trading electronically, we understand that there is uncertainty with respect to the location of execution. For example, if a firm has, say, an Irish client of a UK inwardly passported institution with a head office in the Netherlands, which trades on Eurex.

The issue of location of execution is further complicated where there is linkage directly between a firm's client and the exchange's server so that orders do not pass through the systems of the member firm prior to the execution of the trade.

The FOA would, therefore, welcome clarificatory guidance from CESR on the location of execution for pan-EU electronic trading.

(c) Information which is necessary to identify the ultimate client on whose behalf the transaction is undertaken or information which is necessary to establish the identity of the investment firm which is dealing with the ultimate client where the

competent authority is not already in possession of such information or where it could not obtain such information in a sufficiently timely manner

Please see response to Q1 above.

In addition, as CESR will be aware, a client may use an executing broker to execute an on-exchange derivatives trade and another clearing broker to clear their trades. In this case, the full, long-term, client relationship usually rests with the clearing broker, to whom the executing broker 'gives-up' the trades.

Before the implementation of MiFID, many clearing brokers transaction reported for the executing brokers, as they usually had fuller details of the underlying client. MiFID, however, places an explicit obligation on executing broker to transaction report the trades that they execute for clients. Whilst executing brokers could, of course, delegate the task, clearing brokers (who are **not** under an obligation to transaction report themselves when acting in this capacity) do not have systems in place to transaction report as if they were the executing broker. After long and constructive discussions with the FSA, executing brokers in the UK are, therefore, implementing significant and costly changes to their IT systems to enable them to transaction report at the end of the transitional period for AII regulated markets. The FOA considers it vital, therefore, that a consistent approach is taken with respect to the transaction reporting of 'give-up' business across the EU and would urge CESR to discuss the particularly issues involved with both the FOA and the FSA.

4 Response to Q3

In your opinion, what are the advantages and disadvantages of competent authorities systematically receiving transaction reports covering the information referred to in item (c) above versus acquiring that information on an ad hoc basis by other means?

Transaction reporting of client-side information, although understandable, has resulted in issues for firms (see responses to Q1 and Q2). However, given the level of firms' investment in the architecture of their transaction reporting systems to meet these obligations, we understand that firms, on the whole, consider it advantageous to systematically report client side information to their competent authority rather than deal with *ex post* ad hoc requests for information, some of which can be quite burdensome in their scope and depth.

Firms would, however, like to see competent authorities make fuller usage of the client-side information that is being reported, with ad hoc requests for further information only when strictly necessary. We would also urge CESR to establish guidelines on ad hoc requests e.g. that they should be made via TREM / the relevant competent authority rather than direct to firms.

5 Response to Q4

On the basis of their pros and cons, what would be the preferred solution in relation to the possible convergence of the scope of the transaction reporting obligation (regarding what constitutes 'execution of a transaction')? Please provide justifications for your choice. When analysing the pros and cons, please consider also whether there is a danger of regulatory arbitrage if the scope of the transaction reporting

obligation is not harmonised between Member States, as well as the implications for transparency calculations on shares considering that in the future these calculations will be conducted on the basis of the transaction reporting data?

We are mindful that the inclusion, by some competent authorities, of client-facing firms within the scope of transaction reporting is considered necessary for market monitoring /surveillance. We are also conscious of the fact that the current differences in scope across the EU are inequitable and need to be harmonised. However, given that the majority of our members are market-facing firms, we will leave this question to be addressed by those associations representing client-facing firms.

That said, the FOA does **not** believe that it would be appropriate to harmonise the scope of transaction reporting at the cost of placing additional burdens on market-facing firms e.g. if they were to be required or expected to provide further and better particulars on client-facing firms with whom they deal, in order to make up informational shortfalls.