Alternative Investment Management Association

CESR
11-13 avenue de Friedland
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France

Submitted online via CESR's website

16 August 2010

Dear Sirs,

The Committee of European Securities Regulators' Consultations on:

- **Standardisation and exchange trading of OTC derivatives and**
- **Transaction Reporting on OTC Derivatives and Extension of the Scope of Transaction Reporting Obligations**

The Alternative Investment Management Association (AIMA)[1] welcomes the opportunity to respond to the Committee of European Securities Regulators' (CESR) Consultations on Standardisation and exchange trading (the "standardisation and exchange trading consultation") and Transaction Reporting on OTC Derivatives and Extension of the Scope of Transaction Reporting Obligations (the "transaction reporting consultation").

AIMA supports CESR's and the European Commission's work to assess the need for further standardisation within the over-the-counter (OTC) derivatives market, looking at the benefits and limitations of standardisation and where it may be possible to move OTC contracts successfully and efficiently onto organised multilateral trading facilities (MTFs) and venues. AIMA believes that standardisation is a desirable goal for the market and that the European Commission and the European Member States' competent authorities may be able to play a role in encouraging greater standardisation. However, we also realise that not all contracts will be appropriate or suitable for exchange trading or for increased standardisation and that there are limits to the amount of, for example, product uniformity that can occur before the products no longer meet their hedging and risk-reducing purposes. The market should play the major role in deciding whether standardisation can and should occur.

AIMA also appreciates CESR's and the European Commission's consideration of how the transaction reporting regime for OTC derivatives will operate under the Markets in Financial Instruments Directive (MiFID) (2004/39/EC) if the European Commission proceeds with its European Markets Infrastructure Legislation (EMIL). We agree with CESR that having two sets of obligations to report should be avoided as unnecessary and inefficient and that a method of organisation of transaction reporting should be agreed that grants competent authorities access to the high-quality information they require.

We provide at Annex 1 an executive summary of AIMA's views and responses to the specific questions posed at Annex 2 and 3.

[1] AIMA is the trade body for the hedge fund industry globally; our membership represents all constituencies within the sector – including hedge fund managers, fund of hedge funds managers, prime brokers, fund administrators, accountants and lawyers. Our membership comprises over 1,100 corporate bodies in over 40 countries.

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Conclusion

AIMA supports standardisation within the OTC derivative markets and exchange trading but recognises that there are both limits to the extent that contracts can and should be exchange traded and reasons for maintaining an OTC derivatives market. We hope to continue working with the Commission, providing assistance wherever possible. If you would like to discuss any of our comments further, please do let me know.

Yours faithfully,

Mary Richardson
Director of Regulatory & Tax Department

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ANNEX 1

EXECUTIVE SUMMARY

Standardisation and exchange trading consultation

- AIMA agrees with CESR's assessment of the degree of standardisation of OTC derivatives. However, it does not include contractual netting advantages, which are less available if the markets are mixed between OTC and exchange traded contracts so that there are greater numbers of counterparties.

- AIMA agrees that, where possible, standardisation is desirable and should be encouraged, although we encourage the Commission to consider the benefits of OTC trading and the continuance of some OTC markets to cover bespoke transactions and business needs.

- AIMA believes that central clearing and exchange trading perform important but distinct services to the market. Accordingly, the criteria by which contracts are judged to be suitable for each should be different and reflective of their specific functions.

- Similarly, AIMA broadly agrees with CESR's assessment of the benefits and limitations of exchange trading but believes that only the market can determine whether there is a need for exchange trading in a particular asset class or market sector (e.g. for 'organic' rather than forced growth).

- AIMA appreciates that CESR's proposal to mandate the use of electronic confirmation systems would reduce operational risks in the market. However, in practical terms, industry-wide confirmation systems would struggle to accommodate all possible variables.

- The concept of liquidity is miscast in the consultation: while liquidity allows for exchange trading to operate successfully, non-liquid trades could unsuccessfully be listed on exchanges (i.e. with few buyers) and listing on an exchange does not itself create significant liquidity.

- The other factors which CESR lists as characteristics and levels of standardisation for contracts to be traded on organised platforms are the standard factors an exchange will consider when choosing whether to list products. Those factors will help them decide whether trading is going to be economically viable, rather than whether it is possible to trade the contracts on exchange.

- Although we are not aware of any instances in which an exchange traded contract is not centrally cleared, CCP clearing is not an essential pre-determinant factor for whether a contract can be traded on exchange. Put simply, CCP clearing is not a sufficient criterion for exchange trading.

- AIMA believes that other organised platforms and trading facilities (MTFs, systemic internalisers, etc.) may be suitable for trading of OTC derivatives, although some will not provide the benefits sought and which a regulated market exchange would provide.

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Transaction reporting consultation

- AIMA's hedge fund manager members generally fulfil their obligations to report by relying on their brokers to report the trades on their behalf; to avoid duplication and undue cost, it is important that this is still possible under either of the options which CESR proposes.

- The consultation paper does not cover the scope of reporting under EMIL as compared with the obligations in MiFID. Without knowing whether the scope of reporting is comparable, it is difficult to compare the options properly.

- If option 1 is chosen and all trades were reported to trade repositories, it remains unclear whether the repositories will be established as public utilities or as a single fee-charging firm or whether there will be a competitive market in fee-charging trade repositories. There are potential monopoly concerns with regard to a single fee-charging firm operating a trade repository, while any private firm operating a trade repository will raise concerns about confidentiality.

- If option 2 is chosen and parties have a choice where to report, it is unclear how firms that choose to report directly to the competent authority (as currently required by MiFID) will get the information to the trade repository, which is intended to be a source for all national regulators, competent authorities and other relevant bodies. Duplicative reporting to competent authorities and the trade repositories is inefficient and should be avoided.

- On balance and in so far as is possible without sight of the proposed standards in EMIL and the proposed ESMA binding technical standards, AIMA supports option 1.

- The proposal to extend reporting under MiFID to instruments traded only on MTFs and to OTC derivatives is supported on the basis that competent authorities must have all available information to assess risks to the financial system.

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ANNEX 2

STANDARDISATION AND EXCHANGE TRADING CONSULTATION QUESTIONS

Concept of standardisation	
1.	**Do you agree with CESR's assessment of the degree of standardisation of OTC derivatives? Is there any other element that CESR should take into account?**
	Yes, we largely agree with CESR's assessment of the degree of standardisation, under the three elements of standardisation: legal uniformity, process uniformity and product uniformity. The measures of standardisation are the correct ones and we do not feel there are any other elements which should be taken into account. With regard to electronic trade confirmations, AIMA members expected that the percentage of trades for each class of derivative would be higher than the figures stated, although we have no specific data to contradict CESR's figures. We suggest that the market may already be addressing this concern to some extent and that a later version of the ISDA Operation Benchmarking Survey is likely to show improvements in this area.
2.	**Do you agree with the benefits and limitations of standardisation noted above? Please specify. Can you also describe and where possible quantify the potential impact of the limitations to standardisation? Are there any other elements that should be considered?**
	Yes, AIMA agrees that CESR has noted the main benefits and limitations of standardisation. Operational risk reduction caused by standardisation of contracts is clearly a benefit to the market and greater automation and simplified standard processes are likely to lead to cost savings for all market counterparties. Standardisation of a product does also facilitate the use of central clearing with a central clearing counterparty (CCP). However, the main factors that encourage central clearing are likely to be the cost of clearing with a CCP against clearing bilaterally with the counterparty and whether central clearing is likely to lead to significant credit risk reduction. In comparison, the recently enacted US Dodd-Frank Wall Street Reform and Consumer Protection Act calls for all standardisation products to be traded on exchanges (or other organised trading facilities) and centrally cleared. The US legislation considers, as CESR does, that standardisation will facilitate both the use of clearing and the use of electronic trading venues, although the US authorities consider there to be a single definition of what a 'standardised' contract is. We are not wholly in agreement and would make the point that certain contracts which have standardised legal and process uniformity (for example) may be too bespoke to be successfully traded on exchange, although they may still be suitable for central clearing with a CCP. Central clearing and exchange trading perform important but distinct services to the market (e.g. reducing credit-risk and improving price transparency, respectively) and thus the criteria by which contracts are judged to be suitable for each should be different and reflective of their specific functions. With regard to limitations of standardisation, the biggest one is the legitimate need for bespoke products. Both financial and non-financial institutions use OTC derivatives as a means to hedge a number of risks that arise in conducting their business and any regulatory interventions that seek to improve standardisation should have in mind that the *raison d'etre* of derivatives is to cover off specific business risks. There are instances where a highly bespoke product is needed to cover a very specific risk, which is not common in the market and thus cannot be covered by existing standardised exchange traded products. However, there will be instances where the risks are common or can be adequately met by

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	available standardised exchange traded products and where the benefits will outweigh the limitations for the parties. Not covering off such risks can lead to build-ups of risk in the market and potential failures of firms and/or markets. CESR correctly takes account of the fact that many exchange traded derivatives which are common today began as OTC contracts and that the OTC market is necessary to facilitate innovation and thus provide greater risk reduction for companies and the wider market. Additional factors which CESR should consider are the ability to net off derivative positions and the use of portfolio margining, which allows for margin payments to reflect more accurately the actual risk of the positions held between the counterparties. The result of position netting is often a reduction in the amount of margin that is required to be posted, so that firms have resultant financial benefits and can divert capital into other worthwhile ventures. Where standardisation leads to a majority of trades being conducted on exchange, the number of counterparties will increase, leading to greater numbers of trades that cannot be netted. A further consideration is that OTC trading cannot be conducted at the same pace as exchange trading, so that levels of price volatility are generally reduced in OTC trading. The so-called 'flash crash' of 6 May 2010 was in part exacerbated by the speed with which the undetermined shock was transmitted through exchanges using automated trading systems. We do not believe such automated trading systems are necessarily bad for markets (they provide liquidity and risks can be negated by appropriate rules and exchange systems) but there are possible benefits in terms of low price volatility with privately negotiated off-exchange contracts.
3.	**Do you agree that greater standardisation is desirable? What should the goal of standardisation be?**
	AIMA supports CESR's goal of greater standardisation and believes this is a desirable goal for the reasons stated. However, we do not believe that mandating standardisation or too forcibly encouraging standardisation is desirable. As stated, there is a need for an OTC market to provide proper risk coverage and allow market innovation and this should not be actively discouraged. The goal should, where possible, be to encourage standardisation, to bring about the benefits listed, but with proper consideration of the benefits of the OTC market. The goals should not be arbitrary percentages or numbers of contracts cleared by asset class but should instead reflect the promotion of the benefits of standardisation and a market-led move towards further exchange trading and CCP clearing.
4.	**How can the industry and regulators continue to work together to build on existing initiatives and accelerate their impact?**
	In the EMIL proposal, as proposed in broad terms in the EC consultation on Derivatives and Market Infrastructures, the European Commission suggests that the use of CCPs will be encouraged by favourable margin and capital treatment, when compared with bilateral clearing for financial firms (non-financial firms expecting to receive some exemption). The US Dodd-Frank Act also proposes similar economic incentives using capital treatment and margin modelling to encourage the further use of CCPs. We are aware that in the US, the New York Federal Reserve has been seeking agreement within the industry that further contracts will be cleared and in several agreement letters over 2009 and 2010 it set specific targets that the industry agreed to meet. However, now that the US Dodd-Frank Act has been signed into law, it must be expected that this process has come to an end and that the main impetus will be the economic incentives mentioned within the legislation. The industry initiatives and legislation both seek to increase standardisation towards greater use of CCPs, but do not seek greater standardisation for the purposes of exchange trading (although to the extent that the use of CCP makes exchange trading a cheaper option it will increase).

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	The industry, coordinated by regulators, can assist some elements of standardisation by arranging industry meetings and seeking adoptions of common standards in, for example, certain transaction documentation and valuation methodologies, etc. While there are certain areas in which broad agreement should be possible, it should be the industry that reaches such agreement, since it is the industry which must facilitate any areas of standardisation, giving due consideration to its use of derivatives, the need for bespoke products and the economic consequences of standardisation. In short, the regulators' role (aside from the economic incentives mentioned in EMIL) should be to facilitate and encourage industry initiatives that make for standardisation where that is possible.
5.	**Are there any obstacles to standardisation that could be removed by regulatory action? Please elaborate.**
	We feel that one of the main obstacles for standardisation (and its goal of greater use of exchange trading and CCP clearing) is the dealer banks, many of whom profit financially from the fact that they are the only ones able to offer bespoke products to the market. In some areas, standardisation and exchange trading are likely to be disadvantageous to some dealers, and there is concern that despite incentives and initiatives, many dealer banks may be able to disrupt the process of increasing standardisation. Although we do not suggest that regulators force banks to standardise their products, list them on exchanges or clear them with CCPs, the capital and margin treatments for dealers will be one element that will encourage standardisation. Additionally, on the matter of what is eligible to be cleared, AIMA strongly supports the Commission's proposal in EMIL to set up risk committees at CCPs, comprised proportionately of sell-side dealers and buy-side financial and non-financial firms, which can vote on issues such as what is considered standardised and thus eligible to clear.
6.	**Should regulators prioritise focus on a) a certain element of standardisation and/or b) a certain asset class? Please provide supporting rationale.**
	There will be certain elements of standardisation, such as electronic confirmation of trades, which may be simpler to address than others and, where markets are moving to produce greater standardisation in any case, they are likely to be the best areas to prioritise. Other areas, such as uniformity of products' economic terms should, in the majority of cases, be left to the market to standardise where possible, and should be given a lower priority. Although it would seem natural to focus regulatory efforts on standardising certain asset classes which are not currently standardised, there are often reasons why such asset classes do not yet experience the same levels of standardisation. Factors include the types of market participants, the size of the market, the maturity of the market and the complexity of the product involved. While credit derivatives are currently the most standardised, it is likely that there was a need for standardisation in this asset class, that the size and maturity of the market meant that exchanges and clearing houses were economically viable and were therefore established and, accordingly, that a relatively large number of market users demanded improved legal documentation and processes to deal with the volume of trades. In other areas, such as equities where CESR assesses the level of standardisation to be 'limited', it seems clear that momentum is already in place for reform – for example, the investigation into creating an equity market master confirmation agreement - and that further standardisation will follow. There will be some forms of standardisation where the nature of the product does not lend itself easily (or at all) to being standardised, so that there should not be unnecessary focus on certain elements of standardisation that will not be possible or lead to much benefit.

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	Accordingly, regulators should not prioritise any one asset class but should encourage, where possible, any element of standardisation within any asset class that could be the subject of reasonable reform.
7.	**CESR is exploring recommending to the European Commission the mandatory use of electronic confirmation systems. What are the one-off and ongoing costs of such a proposal? Please quantify your cost estimate.**
	AIMA appreciates the benefits of CESR's proposal for mandatory use of electronic confirmation systems. However, in practice it is likely to be very difficult to implement mandated systems. For bespoke products, any system that attempts to use a standard form to record all aspects of a trade for confirmation is unlikely to prove adequate or workable because of the large number of variables that exist. If a confirmation system were mandated, we would expect that, in order to ensure comparable confirmation reports, a single system would have to be used, giving a single software vendor a large monopoly over the software and the ability to charge unreasonable prices. Even if those concerns could be overcome, there is likely to be concern among smaller financial and non-financial buy-side firms that operating electronic confirmation systems would be costly for their businesses, especially if they are infrequent traders, and a *de minimis* standard would probably have to be applied. As many firms have already sought greater use of electronic confirmation systems, to reduce their operational risk associated with errors in agreeing trades, where it is viable to do so, this would seem an unnecessary area in which to mandate use.
Benefits and limitations of exchange trading	
8.	**Do you agree with the assessment done by CESR on the benefits and limitations of exchange trading of OTC derivatives? Should any other parameters be taken into account?**
	CESR has identified a number of benefits and limitations to the use of exchanges for trading derivatives and we believe that better price formation and reduction of operation efficiencies, including easier successful confirmation of trades and straight through processing for clearing and settlement, are particular benefits of exchange trading that are important to AIMA members. While liquidity may be slightly improved by trading OTC contracts on exchange, by allowing for further firms to be involved in the market, our view is that the gains in liquidity are unlikely to be significant as a direct result of exchange trading. The limitations which CESR has identified are also correct, as discussed earlier in relation to the more general limitations on standardisation. CESR also rightly notes the issue of the limitation of 'excessive' transparency on an exchange, including the risk that listing large numbers of the same or similar contracts within a short period is likely to move the market price beyond that which reflects genuine supply and demand for the contract. This, of course, is less of an issue for exchanges that take advantage of large-in-scale pre-trade transparency waivers.
9.	**Which sectors of the market would benefit from/ be suitable for (more) exchange trading?**
	The benefits of exchange trading are unlikely to apply to certain sectors of the market only; they are likely to be relevant to some extent to all sectors. However, presumably those market sectors with smaller numbers of participants (e.g. equities) will benefit from greater price transparency and equal market access is likely to create some liquidity. Large markets with a diverse range of counterparties (e.g. interest rate futures, forwards and swaps), if they are amenable to CCP clearing, would probably be better able to accommodate successful central clearing and settlement because the size of the market creates liquidity and makes it economically viable to set up exchange trading and clearing operations. However, there may be factors - including the complexity and bespoke nature (e.g. the range of options

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	of the contractual terms 'menu') - which mean that a trade will be less suitable for exchange trading, despite the benefits this could bring. AIMA favours a market-driven move from OTC trading to exchange trading, with regulators taking a role in facilitating further moves to exchange only if there is market demand.
10.	**In your view, for which sectors of the market will increased transparency associated with exchange trading increase liquidity and for which sectors will it decrease liquidity? Please specify.**
	Any of the contracts that trade in large or high volumes (e.g. interest rate swaps) could become less liquid as a result of exchange trading, although this may be offset by increased liquidity which equal market access could bring. Small and low volume trades (e.g. equity options) could become more liquid as a result of exchange trading, taking into account other contributing factors.
11.	**Do you identify any other elements that would prevent additional OTC derivatives to be traded on organised platforms?**
	Exchange trading is affected by the willingness of exchanges to accept contracts for trading, so that one element which may affect the moving of OTC contracts onto exchange is whether there is sufficient liquidity to make exchange trading successful and worthwhile. The overall number of contracts, and the notional amounts of trades outstanding, has decreased since the financial crisis of 2008 and the total number of contracts being listed on exchanges may continue to decrease if the market feels that it is not as economically worthwhile, given capital treatment and margin requirements, to enter into such trades. Overall trends in reduced numbers of contracts would not, however, be reflected as a percentage of contracts admitted to trade on exchange.
12.	**How should the level of liquidity necessary/relevant to exchange trading be measured?**
	A single level of liquidity (measured by how often the contracts are bought and sold) should not be set as a threshold for when a contract can or should be exchange traded. The ultimate deciding factor should be an exchange's decision as to whether it can successfully and viably list a product. Exchange trading in and of itself does not create liquidity; rather, it provides a more equal, open and transparent system in which buyers and sellers may create liquidity. An illiquid contract could be listed on exchange but it will not sell unless there are willing buyers. Liquidity is one of the factors that exchanges consider when deciding whether a product is economically viable and, therefore, will be successful in listing. As discussed in our response to Question 9, the decision should be left to the market. If regulators force contracts which are not suitable to be exchange traded, then exchanges will be forced into the costly and risky position of listing contracts without buyers, and may subsequently fail.
Factors affecting standardisation	
13.	**Do you agree with CESR's assessment of the characteristics and level of standardisation which are needed for a contract to be traded on an organised trading platform?**
	As we discuss under Question 12, the factors listed are those which an exchange would consider when deciding whether or not to list, and are thus the characteristics and level of standardisation likely to allow a contract to trade successfully. Each such factor alone is not essential for exchange trading (e.g. a small number of buyers in the market may lead to low levels of exchange trading, but some trading will still occur). Those are, however, the correct factors to consider in deciding whether a contract should be listed on an exchange. Market liquidity, with sufficient numbers of buyers and sellers, is likely to be the most important element in making exchange trading of a contract a success.

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14.	**Is the availability of CCP clearing an essential pre-determining factor for a derivative contract to be traded on an organised trading platform? Please provide supporting rationale.**
	No; it is possible for a contract to be traded on an organised trading platform but to be bilaterally cleared by the counterparties who have traded. There are certain key difficulties of doing so, however, including that where the buyer and seller are anonymously matched via an exchange, the parties would be put in a situation where they would have to quickly assess the credit risk of dealing with their counterparty and agree appropriate collateral arrangements – such things are done before execution when traded OTC. This issue becomes a greater concern when the contract has a short maturity and is due for imminent settlement after execution. For these reasons, it is an uncommon practice and AIMA is not aware of any instances in which exchange traded contracts are not subject to central clearing at a CCP connected with the exchange. By using exchanges, straight through processing brought about by necessary standardisation makes the process of using a CCP to clear the product the easiest and most efficient option. Exchange trading without CCP clearing may occur where there is no CCP yet available to clear the asset class, and in theory we do not see this as a barrier to exchange trading, although for the reasons stated above we recognise that there are practical difficulties regarding collateralising and settling transactions executed with anonymous counterparties. The same is not true for contracts traded off exchange, where it is easily possible to have OTC contracts centrally cleared, such as in the bond markets. The benefits of central clearing (e.g. reducing credit risk) are different from the benefits of exchange trading (e.g. transparency), and the criteria for each to be viable are also different. Therefore, neither is a pre-determining factor for the successful implementation of the other.
15.	**Is contract fungibility necessary in order for a derivative contract to be traded on an organised trading platform? Please provide supporting rationale.**
	As discussed in the answer under Question 13 above, contract fungibility is an important element to allow successful exchange trading but it is not essential. If contracts are not fungible, then continuous exchange trading of contracts is difficult and would require individual listings for each variant of the individual contracts, and thus low levels of market liquidity. However, many similar contracts could be bought and sold on exchanges without them being fungible, so that that quality is not necessary for exchange trading, although it does bring other benefits, such as the ability to net two or more contracts.
16.	**Which derivative contracts which are currently traded OTC could be traded on an organised trading platform? Please provide supporting rationale.**
	The market is the best method for determining which currently traded OTC contracts could instead be traded on exchange, where buyers, sellers and the exchanges will make that determination based on a combination of the costs and benefits of doing so. Recognising that the factors CESR notes as being important considerations for whether a product can be exchanged traded are variables, the derivatives contracts that could be moved onto exchange will be those where there is a growing underlying market, a growing demand for the derivatives, an increase in the availability of CCP clearing and the increase in the fungibility of a type of contract. As these factors (excluding central clearing) are likely to change over time, corresponding to factors such as the strength of the economy and the success of other markets, it is difficult to say which contracts could now be traded on exchange as any of the variables for different types of market may change. Central clearing as a factor in determining whether an OTC contract could be traded on exchange is a different matter, as once a CCP is established it is likely, except for failure or continued low demand, to remain in place. Therefore, those markets in which central clearing platforms are being created by firms

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	are likely to be the ones that could see more exchange trading.
17.	**Please identify the derivative contracts which do trade on an organised trading platform but only to a limited degree and could be traded more widely on these types of venues.**
	See our response under Question 16 above.
	'Exchange trading' for OTC derivatives
18.	**In the OTC derivatives context, should any regulatory action expand the concept of "exchange trading" to encompass the requirements set out in paragraph 86 and 87 or only the requirements set out in paragraph 86? Please elaborate.**
	If contracts are to be traded on exchange, these should be exchanges that meet the characteristics and rules for organised trading venues as defined in MiFID. Regulated Markets under MiFID already meet all the requirements set out in paragraphs 86 and 87, so that if OTC contracts are moved onto exchanges they will be subject to the benefits and efficiencies which MiFID is designed to bring. Therefore, it is assumed that no further regulatory action is required to be taken to facilitate this.
19.	**Do current trading models and/or electronic trading platforms for OTC derivatives have the ability to make pricing information (both pre- and post-trade) available on a multi-lateral basis? Please provide examples, including specific features of these models/platforms.**
	Yes, it is possible that current electronic trading platforms which allow OTC counterparties to deal could be adapted to make price information on a multilateral basis.
20.	**Do you consider the SI-regime for shares relevant for the trading of OTC derivatives?**
	In principle, there is no reason why systematic internalisers (Sis) could not adapt to trade OTC derivatives also and to buy and sell positions in contracts which have yet to settle. SIs would improve transparency by the publication of bid and offer quotes and post-trade reporting. SIs do have the same drawbacks as exchanges and because SIs are able to decide which counterparties they trade with, they do not provide open access as regulated exchanges must.
21.	**If so, do you consider that the current SI-regime provides the benefits described above which 'exchange trading' may offer or are amendments needed to the SI obligations to provide these benefits to the OTC derivatives market?**
	As discussed in our response under Question 20, SIs provide many of the same benefits as exchanges in terms of transparency but they are bilateral in nature, with the investment bank deciding whether to deal on its own account and agree to buy or sell. It is not feasible to require investment banks to deal with any counterparties who wish to trade with them; the bank would not enter the market if it were forced to enter into all transactions. To make SI obligations otherwise would be to change their nature and create a multilateral trading facility (MTF). SIs do not, therefore, provide all the benefits of an exchange, although there is demand for their use for trading shares (as there would probably be for trading derivatives) and changes to their nature are unlikely to be beneficial overall for OTC derivatives.
22.	**Which characteristics should a crossing network regime, as envisaged in the review of MiFID, have for a crossing network to be able to be qualified as a MiFID "organised trading venue"?**
	Crossing networks have some conceptual similarities with other organised trading venues but are different in several ways. Although a crossing network essentially allows parties to trade by matching the best buy orders with the best sell orders, to match counterparties, this is not done in a transparent

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	manner and prices are not disclosed openly to the market. Instead, crossing networks require pre-programmed computer algorithms to locate otherwise undisclosed sellers amongst a broker network of access to dark pools. First, a crossing network does not provide the same pre-trade transparency as exchanges but relies on the waivers used by dark pools not to disclose pre-trade bids and offers. As regards post-trade reporting, there is no obligation to report agreed prices to the market, as there is of an exchange. Second, crossing network systems do not operate straight matching of bids and offers, as exchanges do, but instead take into consideration the client's objectives to achieve best execution, such as by slicing large trades to avoid moving the market. Third, crossing networks do not provide execution of the matched orders but only a method by which orders can be matched. Last, there is no open access to crossing systems, as there is with exchanges, and the parties are only those clients which brokers agree to match. Although crossing networks can provide a useful method for matching client orders, including possibly for OTC derivative contracts, it is difficult to see how they could be considered 'organised trading venues'.
23.	**In your view does the envisaged legislative approach in the US leave scope for regulatory arbitrage with the current EU legislative framework as provided under MiFID? Would regulatory measures taken in the EU to increase 'exchange trading' of OTC derivatives help to avoid regulatory arbitrage?**
	AIMA's view is that in terms of firms being able to take advantage of a lesser requirement in the EU, as opposed to the US, for OTC derivative contracts to be traded on exchanges, it is unlikely to be an issue that participants would significantly favour one jurisdiction and its regulatory regime over another (i.e. take advantage of regulatory arbitrage). The cost implications for exchange trading against OTC trading are likely to be negligible and would, accordingly, not favour one regime over another. It is possible that some market participants, those trading large volumes or trading frequently, would favour a regime which did not place so strong a requirement for trades to be exchange traded and, therefore, to report pre- and post-trade. To that extent, increasing exchange trading would lower that risk of regulatory arbitrage, although forcing more contracts onto exchange to achieve that is not likely to be desirable (e.g. because innovation would be impeded, and there would not be the ability to hedge specific risks with bespoke contracts), as discussed above.
24.	**The Commission has indicated that multi-laterality, pre- and post-trade transparency and easy access are key aspects of the concept of "on exchange" trading. Do you agree with CESR applying these criteria in its further analysis of what this means in the EU context, in particular in applying MiFID to derivatives trading?**
	Yes; AIMA agrees that the criteria the Commission indicates are the key aspects of the concept of "on exchange" trading and that the Commission should have in mind these criteria in defining what it means to trade "on exchange" for the purpose of applying MiFID to derivatives trading.
25.	**If not, do you consider that MiFID requirements and obligations should be refined to cover deviating characteristics of other electronic trading facilities? Please elaborate.**
	No; to the extent contracts are able to be traded on exchange, this should be done only on electronic trading facilities which have the concepts of multi-laterality, pre- and post-trade transparency and easy access which would bring benefits to the OTC derivative market.

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Promoting, incentivising and mandating exchange trading	
26.	**Are there any market-led initiatives promoting 'exchange trading' that the regulators should be aware of?**
	AIMA is not aware of any market-led initiatives promoting exchange trading, and we are not aware of any commitments the industry has collectively made to have more contracts exchange traded (such as was organised by the New York Federal Reserve for central clearing). We believe this reflects both the importance of encouraging central clearing of as many suitable OTC derivative contracts as possible and the common belief that the market in exchange traded derivative contracts should be allowed to grow 'organically'.
27.	**Which kind of incentives could, in your view, efficiently promote greater trading of standardised OTC derivatives on organised trading venues? Please elaborate.**
	Aside from extolling the benefits of exchange trading to the market, AIMA does not feel that trading of standardised OTC derivatives on exchange should be economically incentivised. If CESR and the Commission decide that exchange trading of OTC derivatives should be incentivised, it is unclear to us how this could be fairly done. Capital charges are not suitable for incentivising the methods of trading (as is proposed for clearing). Aside from real market intervention to promote exchange trading (i.e. setting fee levels), there is no clear method of achieving this.
28.	**Do you believe there would be benefits in a mandatory regulatory action towards greater trading of standardised OTC derivatives on organised venues? Please elaborate.**
	No. As we have stated, if the exchange traded market is forced to grow, then to be successful it will have to become, amongst other things, more standardised and in doing so it will lose the ability of financial and non-financial firms to enter into the bespoke contracts that properly cover their risks and will hamper further financial innovation that has allowed complex risk to be addressed. The overall result may be a hampered ability to cover risk and, therefore, an increased build-up of risk in the financial system and a greater chance of individual and wider economic failure. These are the risks which central clearing, which should be subject to some level of mandatory clearing, is seeking to address. A 'blanket' ban on OTC derivatives would be highly undesirable for all the reasons given and mandating exchange traded in certain sections of the market is likely also to negatively affect the market, even if a market required to have exchange trading could be chosen fairly.

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ANNEX 3

TRANSACTION REPORT CONSULTATION QUESTIONS

	Concept of standardisation
1.	**Do you agree with the solution proposed by CESR for the organisation of transaction and position reporting on OTC derivatives?**
	Under MiFID, portfolio managers who enter into transactions on behalf of a fund for whom they operate with a registered broker will comply with their obligation to report the trade by having the broker report on their behalf. We believe that this arrangement is the most sensible and efficient for the market as it avoids the submission of duplicative reports to competent authorities and places the cost burden with the party who is most able to bear it. In consideration of either of the options CESR proposes in the consultation, we would hope that this aspect of the reporting regime is maintained. The reporting of OTC derivative trades to the regulators and publicly to trade repositories has two clear objectives: (1) it allows the regulator to monitor firms' trades to aid in the detection of market abuse and manipulation, and (2) it allows the market to review prices and adjust, ensuring that prices are fair and reflect supply and demand for products and that parties can achieve best execution. We broadly support any method that allows for public reporting and reporting to the regulators in an aggregated, anonymised form. In assessing the two options which CESR proposes, it is difficult, however, to assess the two options without knowing whether the information required to be reported under MiFID will be the same information required to be reported to trade repositories under the Commission's proposed EMIL; if the standards differ, then the options are not as clear as stated and it would be likely that an additional report would be required to be reported to one or the other. In the interests of efficiency and reducing costs, it would be best if there were a common standard for the information required to be reported as the information to assess firms required by one competent authority is likely to be the same as the information which other competent authorities and national regulators require. In assessing the first option that CESR proposes – to report all trades only to trade repositories –firstly, this only works, as discussed, if the types of information required are the same. It is unclear currently what type of entity the trade repository or repositories will be under EMIL. If it were a public utility, then this would be very similar to reporting to a national regulator and there is no reason why the task could not form part of the regulator's functions. If the repository were a single private firm, which makes most sense as a single point of information, then its ability to charge fees while market participants are obliged to report to it raises competition concern for the market. A competitive market in trade repositories, where multiple firms operate, would require some form of coordination to collate data and would therefore have some inefficiencies. If the trade repository function were fulfilled by one or several private companies, there is likely to be real industry concern regarding reporting its trades in confidence to such firm(s) as much of the data will be confidential and proprietary in nature. Under the second option – to report to the competent authority having the option to use trade repositories as a valid third party reporting mechanism under Article 25(5) of MiFID – again, a confusing situation would arise if the information required to be reported to the competent authority were different from that required to be reported to the trade repository as required by EMIL. Additionally, recognising that trade repositories will be the central store for all derivatives information and which any competent authority could access, the proposed solution would need to ensure that all the information

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	reached both the competent authority and the trade repository. Should it be an option to report only to the competent authority for the purposes of MiFID but also to report to the trade repository for EMIL, there would be a requirement to report similar information twice. Duplicative report requirements would be an inefficient way of disseminating information and should be avoided where possible. For these reasons, AIMA believes that the first option is likely to be preferable for our members who are required to report themselves, as long as data confidentiality is tightly controlled and monitored by a competent authority.
2.	**Do you have any other views on the possible ways to organise transaction and position reporting on OTC derivatives?**
	No; we think that option 1 is likely to avoid duplication of reports, as long as it is standardised, and it should be the option CESR proposes.
3.	**Do you agree with the extension of the scope of transaction reporting obligations to the identified instruments?**
	As stated in our answer under Question 1, we feel that there are good reasons for reporting to regulators and the public and we would support the extension of the scope of transaction reporting to financial instruments admitted to trading only on MTFs and to OTC derivatives to the extent this improve efficient markets, the ability of the regulators to detect market abuse and the ability of regulators to assess financial systemic risk.

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