Association of British Insurers

Call for evidence on the review of the scope of the MiFID transaction reporting obligation

The ABI's Response to CESR 08-873

The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

We have been actively involved in the field of transaction reporting and have on several occasions in the past communicated our concerns to CESR and the EU Commission.

Our members believe that CESR's review of the regime is both timely and necessary. There remains a lack of clarity about where and how the obligation to report transactions applies. This is evidenced by the different interpretations of CESR guidance on scope by member states. Specifically, the UK FSA has made portfolio managers subject to transaction reporting, a move which does not seem to have been replicated across the EU, and which we do not think was not intended by MiFID. This difference in regimes raises legitimate questions about competitiveness and regulatory arbitrage which the regulators need to address. We would therefore call for more clarity and consistency in how the obligation is interpreted and applied across by member states.

We would also urge CESR to coordinate the production of a list of reportable instruments. The industry has called for a list to be published at the time of MiFID introduction and it is still keen to have it. A comprehensive list available to everyone should help both firms and regulators.

If you have any questions, please do not hesitate to contact me.

Yours sincerely,

Danka Starovic
Policy Adviser, Investment

Appendix I

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

2. **Please provide information on your practical experiences in reporting transactions 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 have you encountered problems?**

3. **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?**

4. **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?**

The ABI members believe there is – and there has been from the outset – a fundamental lack of clarity about the scope of the transaction reporting obligation. CESR guidance succeeded in clarifying certain aspects of it but has not, in our view, resolved all the issues. This has been exacerbated by the way in which the FSA has chosen to implement the MiFID rules in the UK.

Executing transactions – a definition

As CESR guidance recognized, the root of the problem lies in the lack of clarity in MiFID around what precisely the execution of transactions means and how it differs from the execution of orders.

Article 25 of MiFID seems to make a distinction between all investment firms (and the obligation to keep record of all transactions which they have carried out) and those investment firms which execute transactions (and the obligation to report details of such transactions to the competent authority). We believe that portfolio managers rarely fall into the latter category, by virtue of the service they provide and the way in which they interact with the market.

CESR's guidance, though it tried to distinguish between execution of orders and execution of transactions, was interpreted differently by different member states. Some, like the FSA, require portfolio managers to report despite the fact that they do not deal on own account and most of their trading is done through brokers, i.e. market facing firms.

This lack of consistency is clearly not helpful for firms as it puts some at a competitive disadvantage. It also creates opportunities for regulatory arbitrage across the EU.

Also, some confusion remains about how the guidance applies in different situations. For example, when a portfolio manager goes to a non-EAA broker who is not dealing on own account, the FSA requires a report, despite the fact that one could argue that the non-EAA broker is the market-facing firm. Or, for example, it is not clear whether agency crosses fall under point b) considering that portfolio managers do not have permissions to deal on own account and instead act as agents for clients.

The FSA regime – super-equivalences

The regime created by the FSA has resulted in portfolio managers not reporting in some instances, because they can rely on brokers to do it on their behalf, but having to report in others, because the broker is either not a MiFID investment firm and the instrument is listed in the EAA, or because the instrument being transacted is super-equivalent to the core MiFID requirements. They also have to report when they cross orders internally or trade with each other directly.

The FSA imposed direct super-equivalences in the scope of instruments to be reported. For example, it requires the reporting of transactions in OTC derivatives which are priced or valued by reference to debt or equity instruments admitted to trading on a prescribed or regulated markets or to indices constituted by those instruments. Also, all transactions carried out on a prescribed market have to be reported. (The FSA Handbook in fact wrongly labels these rules as being required by MiFID in SUP 17.1.4 and this reference has not been corrected since transposition.)

This difference in scope, and the ‘piecemeal’ manner in which the FSA applies the obligation to portfolio managers, have put portfolio managers in a difficult situation. For example, firms which rely on brokers for almost all of their reporting may find themselves in a position where, if transacting with a non-UK broker in super-equivalent instruments, they would be left with the obligation to report. For some of our members, the low volumes of such transactions make matters worse, as disproportionate amounts of money are spent on identifying the transactions in question and having the systems to deal with them.

The consequences are twofold – portfolio managers are potentially discouraged from using brokers outside the UK or, if they do use them and have to report, it requires them to develop systems to do so themselves. For firms who have previously not had reporting systems, this is particularly onerous.

The costs reported by our members are significant, both in terms of the initial costs of system set-up and ongoing costs. And they keep rising – the fact that the FSA keeps making what they believe are small changes is extremely unhelpful for firms – the continued ‘tinkering’ requires costly systems changes and training.

Costs may arise over time even in cases where the broker agrees to report despite having no regulatory obligation to do so: for brokers, this is a commercial decision and the rationale for it may change in the future.

More generally, we would question the need for total market surveillance which seems to drive policy-making in this area. The amount of information that would be missed if portfolio managers stopped reporting these contentious transactions would be minimal. In any case, as the data has to be kept by the firm for five years, the regulator would have access to it if necessary.

We would like to see more evidence that collecting information about every trade conducted in the market is in fact helpful in combating market abuse. It has become a truism that more information is always better and we fear this view will become even more prevalent in times of market turmoil. We would suggest that the huge volumes of data mean that at some point there has to be a case of diminishing returns. We would urge CESR members to examine more thoroughly the costs and benefits before making any policy choices.

Introducing broker exemption

Another problem encountered by UK portfolio managers which shows the difference in interpretation across the EU has been the so-called ‘introducing broker exemption’. The FSA mandated that when a portfolio manager trades with a UK bank and that bank then passes the order to its non-EU affiliate to be executed, it is the portfolio manager who has to report the transaction to the FSA.

This has come about because the FSA guidance permits the UK bank to be an ‘introducing broker’ and thus effectively exclude itself from the chain of execution. The non-EU affiliate, to which the order is passed, will have no obligation to report either, as it is not a MiFID investment firm.

It is not clear to us how this is possible under MiFID or CESR guidance and how such a broker can be said not to be undertaking a MiFID service. We think the situation misrepresents our members’ relationship with UK banks – and the lack of any such relationship with their overseas affiliates.

A UK portfolio manager will often not know to whom the order is passed at all – this has become an acute problem following the collapse of Lehman’s brothers and the industry-wide reassessment of counterparty risk. It also seems to contradict how MiFID describes the service of receiving and transmitting, which is what we think introducing brokers are in fact doing. Level 1 directive says “For the purposes of this Directive, the business of the reception and transmission of orders should also include bringing together two or more investors thereby bringing about a transaction between those investors.” Other receivers and transmitters could presumably also decline to send their transaction reports to the regulator. It is also not clear why the UK broker keeps all the other MiFID obligations except this one.

Conclusion

To conclude, we think that a year since MiFID came into force there is still a lack of clarity and consistency in how transaction reporting has been transposed and implemented across the EU. The UK portfolio managers have to bear costs that their European counterparts do not and this clearly puts them at a competitive disadvantage. We would urge CESR to resolve these issues in a proportionate manner.