Association of British Insurers

ABI Response to CESR Consultation Paper on Transaction Reporting

The ABI's Response to ref CESR/10-292

The Association of British Insurers (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 twenty per cent across the EU. The UK insurance industry is the largest in Europe and the third largest in the world. Figures published last year show that our members are responsible for investments of £1.5 trillion. They also manage sizeable assets for third party clients.

Thank you for the opportunity to respond to this consultation. We are pleased that CESR has decided to gather views on the issue of transaction reporting and we support the overall aim of the paper to harmonise requirements across the EU to ensure there is a level playing field in terms of firms' obligations. We are therefore in favour of many of the proposals made by CESR.

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However, our members believe that the issue of how the transaction reporting obligation applies to portfolio managers has still not been resolved. CESR notes in .12 that the feedback to its previous call for evidence included a request to address the regulatory uncertainty regarding the firms falling under the regime. We are disappointed that this has not happened.

As CESR will be aware, since the introduction of MiFID, portfolio managers have maintained that they should not be reporting in most cases. This is because in most cases (the exceptions being when orders are crossed internally), they do not execute transactions.

This is not how some European regulators have interpreted the Directive. The result is that firms have ended up bearing what we believe are unjustified costs: some have built systems to report, others have relied on brokers but that reliance has been partial and in some cases unsatisfactory. Many are over-reporting in order to be certain that their transactions are getting through to the regulators.

It ought to be remembered that any additional costs to the industry are often borne by end customers who are ordinary savers and investors and that

over-regulation – either perceived or real – can reduce the attractiveness of the EU as a place in which to do business.

Cost benefit analysis

Generally, our members are concerned about the lack of any serious cost benefit analysis underpinning CESR's proposals and we see this as a major flaw of the consultation paper and the regulators' work in this area so far.

We appreciate that exhaustive transaction reporting information should be useful for regulators to monitor for market abuse and manipulation. However, just because this is a possibility, it does not automatically justify the imposition of large costs on firms. There should be at least some attempt to quantify the costs and benefits of transaction reporting.

As investment managers, we are particularly keen – and arguably keener than intermediaries – to have clean markets in which we have confidence to invest. But we are acutely aware of the dangers of the recent trend in regulation to collect vast quantities of data without providing evidence about how and when it is being used. There is no doubt that the cost benefit analysis in this area is very difficult but it is not impossible. It should, as always, form the basis of any regulatory change.

In particular, it would be extremely useful if the competent authorities could provide evidence of how transaction reporting information is being used in practice. For example, how many cases of market abuse were brought forward as a result of the information reported by firms, how often it was used to corroborate the information gained elsewhere, whether it was used in any policy initiatives to provide data for a particular proposal, and so on. Information that *may* be useful should not always pass the benefit test.

Transaction reporting and portfolio managers

There are several other issues we would like to raise which are not mentioned in the paper. First, we are concerned that there is still no level playing field across Europe in how the reporting obligation is placed on different market participants. As far as we are aware, only a few competent authorities require portfolio managers to report transactions. The UK FSA is one of them.

Although it then ostensibly exempts them in cases where the trade is likely to be reported by a broker in order to avoid duplication, there are plenty of instances where the exemption is not valid and the portfolio manager still has to report. In fact, in some cases firms feel they cannot satisfy themselves that brokers are reporting on their behalf and so have decided to report all their transactions themselves instead. This has obviously led to significant costs being incurred by our members – a large global asset manager would report a huge number of trades every day.

Our members believe the situation places an unfair burden on them and their clients and creates potential for regulatory arbitrage. They would therefore like CESR and the Commission to return to this issue in due course.

As mentioned above, we have always maintained that MiFID Article 25 in fact makes a clear distinction between investment firms more generally and investment firms which execute transactions and therefore have to report them. As investors, rather than intermediaries, our members should never fall in the former category except when they do not use the market at all, such as when crossing orders internally.

Introducing brokers exemption

The problem is particularly difficult when it comes to the so-called introducing brokers and the exemption afforded to them by the UK FSA. Although this is not specifically a European issue in the sense that it stems from a UK idiosyncrasy, it does raise again two serious issues. One is the lack of harmonization across the EU. The other is that there it is still not clear what executing a transaction actually means. We have called for both of these issues to be tackled in the past and the review of MiFID should provide an opportunity to do so.

When a portfolio manager trades with a UK broker and that broker then passes the order to its non-EU affiliate to be executed, it is the portfolio manager who is required to report the transaction to the FSA. He can no longer rely on the UK broker to report, which would be the case otherwise under the UK rules which aim to avoid duplication (SUP17 in the FSA Handbook).

For example, when a portfolio manager gives the order to, e.g. Goldman Sachs London, if the order happens to include a security dual-listed in the UK and the US, Goldman Sachs London is likely to pass the order to Goldman Sachs New York who then executes it on, say, the NY Stock Exchange. Very often, the portfolio manager will not know that this has been done until the trade confirm is received from the US firm a few days later. Another example is where a portfolio manager chooses to trade directly with a non-EAA broker in the security which is dual-listed in the EEA.

This situation has come about because the FSA guidance published after the transposition of MiFID permits the UK broker to act as 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. The obligation thus goes back to portfolio managers, who struggle to identify and pick out the relevant transactions to be reported – in many cases, our member firms just choose to report all their transactions. This is costly over-reporting on a very large scale.

We think introducing broker exemption misrepresents our members' relationship with UK banks – and the lack of any such relationship with their overseas affiliates. 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.

We would urge CESR to recommend in its advice that sufficient transitional periods are embedded in any changes that may come about as a result of this consultation. This is because transaction reporting requires changes to systems and this takes a great deal of time to undertake.

Finally, it would be useful if CESR could clarify how transaction reporting data interacts with the data envisaged to be reported to trade repositories.

Question 1: Do you agree with the above analysis on trading capacity and the proposal to introduce a third trading capacity (riskless principal) into transaction reporting?

We have no specific comments on the mechanics of this proposal as our members would never trade in a riskless principal capacity.

Regarding transactions done by market makers we agree that, before any changes are proposed, regulators should conduct a full cost benefit analysis and develop a watertight definition of market making. The definition should be capable of being used in other contexts – for example, for the purpose of any new rules on short selling where market makers may be exempt from disclosing positions.

We would add that it is not only the competent authorities who would find the information on the volume of market making transactions useful – other market participants would do too. It would provide clarity about how much trading done by the sell-side is in fact linked to market making rather than proprietary trading.

Our members have for some time now questioned how the function of market making, and the various regulatory privileges that attach to it, overlaps with the remainder of an investment banks' activities. In addition, the changing nature of trading, particularly the rise of high-frequency/algorithmic strategies, are changing the nature of liquidity provision in a way that may make market making more 'discretionary', in CESR's words.

If regulators decided to collect information on market making, they should disseminate aggregated figures to the market as a whole, and use the data obtained to monitor more closely the performance of individual brokers.

Finally, we would emphasise that market making is essential for the functioning of capital markets. If banks stopped providing liquidity in this manner, it would be much harder for companies to raise capital. True market

makers should therefore continue to be afforded specific discretions in regulation.

Separately, we would question how the notion of 'introducing broker' fits into the three trading capacities outlined by CESR

Question 2: Do you have any comments on the distinction between the clients and counterparties?

We have no specific comments to make.

Question 3: Do you agree with the above technical analysis?

Question 4: Do you see any additional advantages in collecting client ID?

We do not agree with CESR's analysis. Although it may be technically accurate, we believe the cost benefit analysis is flawed. It is easy to understand why regulators would find the client ID information useful. We have no objection to the idea *per se*. However, that is not in itself a good enough reason to simply require firms to provide it.

It is legitimate to question whether the additional benefit obtained from collecting client IDs would in fact outweigh the costs to firms of transmitting this data. The same goes for every other proposal in this area. Although such an analysis would be difficult to conduct, it is not impossible and we are disappointed that any mention of it in the paper is at best cursory. For example, CESR asserts in paragraph 54 that without a client identifier, it would be impossible for the CA to deduce certain information from the transaction reports without ad hoc requests, which, in turn, increases compliance costs for firms and CAs. Much of this could be measured in some way, either by using real data gathered since MiFID was implemented, or projections. As it stands, it is simply an unsubstantiated assertion.

It would also presumably be possible to quantify the benefits of clean markets in some way by calculating the resulting decrease in the cost of capital for issuers. This could be compared with the aggregate costs to firms of building reporting systems.

As mentioned in the introduction, we are concerned about the new trend in regulation to attempt to collect all data available. We do not believe total transparency is a panacea – in fact, we would question whether the environment it creates is any better at preventing failure. We would question whether regulators across the EU have the capacity – both human and technological - to analyse the vast volumes of transaction reporting data that are being reported to them. Will this additional information enable them to spot potential failures any better?

Any cost benefit analysis should also consider how costs are borne by different sorts of firms. For our members, who are portfolio managers, we believe the costs of reporting obligation vastly outweigh the benefits. Again, we do not think this would be impossible to quantify, especially bearing in mind the very few instances of portfolio managers being involved in market abuse investigations.

Question 7: Do you agree with this proposal?

Question 8: Are there any additional arguments that should be considered by CESR?

Please see our answer to questions 5 and 6. We do not disagree with the proposal but we believe any changes should be based on evidence and analysis.

Question 9: Do you agree that all counterparties should be identified with a BIC irrespective of whether they are an EEA investment firm or not?

Question 10: DO you agree to adapt coding rules to the ones available in each country or do you think CESR should pursue a more ambitious (homogenous) coding rule?

Question 11: When a BIC code has not been assigned to an entity, what do you think is the appropriate level for identification?

Question 12: When a BIC code has not been assigned to an entity, what do you think is the appropriate level for identification (unique securities account, investment firm, national or pan-European)?

Question 13: What kind of problems may be faced at each of these levels?

We would agree that the use of BIC codes which are in the main readily available and generally not difficult to obtain and use probably represents the best identifier currently available.

However, there are circumstances where a BIC code cannot or has not been assigned or where multiple BICs have been issued to the single entity. Therefore, we believe more cost benefit analysis is needed if CESR were to mandate this particular standard. We note that such standards would be costly and complicated to establish – not only in terms of system changes but also in addressing data protection issues and so on.

Question 14: What are your opinions on the options presented in this section?

Paragraph 91 in CESR's consultation oversimplifies both the definition of execution and the obligation as stated in MiFID. We believe there is still a lack of clarity over what precisely counts as execution of a transaction (as opposed to execution of an order) and to whom the Article 25.of MiFID applies.

However, we do agree with CESR's analysis and the contention that client ID should be preserved throughout the chain of execution. Both options presented in the consultation are feasible and we have no specific comments on which would be more appropriate.

Question 15: Do you agree with CESR's proposal on the extension of reporting obligations? If so, which of the two alternatives would you prefer?

We agree. It would seem more proportionate to place the obligation on the persons who are members of RMs and MTFs, rather than the venues themselves.