Wholesale Market Brokers' Association (WMBA) & London Energy Brokers' Association (LEBA) Response to Committee of European Securities Regulators (CESR)

Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity markets transparency

Background to the WMBA and LEBA

WMBA and LEBA members are limited activity firms that act as intermediaries in the wholesale financial markets. Our members' principal (!) client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of member firms acting exclusively as intermediaries, and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products.) For this reason some of the questions in the CP are not entirely relevant to member firms' activities even though they are to most of their clients. Further, some answers take into account industry views and experience. [See annex 1 and annex 2]

We appreciate the opportunity to respond to the 7th May 2010 consultation paper and hope to continue to advance dialogue with the regulatory community and policy makers. We welcome the opportunity to discuss in depth the responses provided in this paper at your convenience. All our members are fully supportive of full and immediate transparency to our respective regulators across all asset classes and jurisdictions covered in the consultation. We support full industry cooperation on all initiatives intended to create transparent and efficient markets and it is the goal of all market participants that the European fixed income & derivatives markets continue to thrive and provide a tangible benefit to the real economy.

At the outset we would like to emphasis the following points:

- Our firms are closely regulated and authorised by the relevant national and home-host authorities. All clients are similarly regulated and "Wholesale" in nature. There is either little or no direct retail involvement in any of these asset classes.
- It is in the very nature of the business of wholesale market brokers to provide the vast non-equities products mentioned in this paper with an optimal level of pre-trade price transparency as is possible in order to promote transaction flows. Increasingly, this audit trial is becoming fully electronic.
- We would highlight the sensitivities of wholesale market participants involved in OTC price formation to public transaction reporting and the consequent possible detrimental effects this may impose upon liquidity and efficacy for the end user. Consequently, we continue to favour and published aggregate volumes and volume weighted average prices (VWAPS) to ensure that participants whose balance sheets provide key market liquidity are not unduly compromised.

- We would note that OTC markets do not adhere to exchange timetables and, accordingly, we endorse and publish VWAPS covering the entire trading day on from midnight.
- We note that an interdealer broker may act either in a “Name Give-Up” or “Exchange Give-Up” capacity, or as a “Matched Principal”. [See annex 1.] These roles may have a different impact on the reporting of trades.
- We would highlight and caution conflicts that may arise in markets of very low or ephemeral liquidity. Such gaps become common in many secondary markets for non-sovereign bond issues. Where the broker acts in the capacity of “Matched Principal”, transaction reporting may be both detrimental and misleading to liquidity.
- All trades are electronically captured and processed. Post-trade transparency and current trade reporting requirements are fully respected.
- We would support some measure of calibration for corporate bond post- trade transparency which we believe would provide increased transparency to retail and smaller institutions but would still protect liquidity in the market for wholesale participants.
- We endorse and support central counterparty clearing where feasible. We note that many CCPs also offer trade matching facilities and we strongly endorse the equal and fair access to clearing from all authorised sources. We would especially note the need for cost and access equality of fee structures as well as electronic protocols in this respect.
- We support the construction of Trade Repositories where they do not currently exist in order to promote the scrutiny and management of systemic risk concerns. We would again caution against the bundling of Trade Repositories with the clearing function as this may bring the utility and commercial priorities into conflict.

Annexes

GENERAL ACCESS TO PRE- AND POST-TRADE INFORMATION
Q. 1. On the basis of your experience, could you please describe the sources of pre- and post-trade information that you use in your regular activity for each of the instruments within the scope of this consultation paper:
a) corporate bonds
b) structured finance products (ABS and CDOs),
c) CDS,
d) interest rate derivatives,
e) equity derivatives,
f) foreign exchange derivatives,
g) commodity derivatives?

Corporate Bonds

Pre-trade

- IDB Voice Quotes
- IDB Pricing Screens
- Dealer "Runs": IDBs speak directly to the dealers and obtain their indications of interest whilst requesting them for quotes.
- Electronic Services: Bloomberg, ThomsonReuters, TradeWeb, BondVision and MarketAxess.
- Price Aggregators: provide an indication of the market: include Markit, Bloomberg and CMA.

Post-trade

- Xtrakter: holds data on the majority of European corporate bonds.
- Xtrakter is estimated to receive data on about 45,000 bonds out of which 60-70% are corporate bonds.

Structured Finance (ABS and CDOs)

Pre-trade

- Dealer "Runs": IDBs speak directly to the dealers and obtain their indications of interest whilst requesting them for quotes.
- Electronic Services: IDB screens, Bloomberg, TradeWeb, BondVision and MarketAxess.
- IDB Voice Quotes

Post-trade

- Markit: most commonly used for end of day pricing.
- Xtrakter/Xbiz: provides post trade reporting.
- DTCC: post trade confirmations

CDS

Pre-trade

- Electronic Services: IDB screens, Bloomberg, Markit, & TradeWeb.
- Dealer "Runs": IDBs speak directly to the dealers and obtain their indications of interest whilst requesting them for quotes.
- IDB Voice Quotes
- Exchanges: ICE, Clearnet, Eurex

Post-trade

- IDB's provide post-trade transparency in the form of saleable data in pretty much every asset class/product
- Global DTCC Trade Information Warehouse (TIW)
- MarkitServe & CMA
- Exchanges: ICE, Clearnet, Eurex (indices only)

Interest Rate Derivatives, Equity Derivatives, Foreign Exchange Derivatives, Commodity Derivatives

Pre-trade

- Electronic Quotation Services [Prices]: IDB screens, Bloomberg, & ThomsonReuters, ECNs
- Electronic Indications Services [Curves, Greeks]: IDB screens, Bloomberg, & TradeWeb.
- Dealer "Runs": IDBs speak directly to the dealers and obtain their indications of interest whilst requesting them for quotes.
- IDB Voice Quotes
- Exchanges

Post-trade

- CLS: For FX
- EFET.Net: For Commodity Derivatives
- CMA: for Credit Derivatives
- IDBs Tic Data Services
- Clearing Houses: LCH.Clearnet, Eurex, ClearPort, ICE Clear

Q.2 Are there other particular instruments that should be considered as 'corporate bonds' for the purpose of future transparency requirements under MiFID?

None

Q.3 In your view, would it be more appropriate, in certain circumstances, to consider certain covered bonds as structured finance products rather than corporate bonds for transparency purposes? Please explain your rationale.

Covered bonds should be seen as a special case of a corporate bond since they are genetically linked to the original borrowing entity.

Corporate Bonds (Q4- Q10)

Q. 4 On the basis of your experience, have you perceived a lack of pre-trade transparency either in terms of having access to pre-trade information on corporate bonds or in terms of the content of pre-trade transparency information available?

In the course of business, IDBs broadcast price transparency across the market for each corporate bond, or generate price discovery on request where little pre-trade information exists. We have not received any systematic complaints from market participants that too little pre-trade transparency exists.

Q. 5 In your view, do all potential market participants have access to pre-trade transparency information on corporate bonds on equal grounds (for example, retail investors)? Please provide supporting evidence.

IDBs are only regulated to deal with professional counterparties.
Retail participants would gather pre-trade information via their professional intermediary or through market price screens such as Bloomberg.

Q. 6 Is pre-trade transparency efficiently disseminated to market participants? Should pre-trade information be available on a consolidated basis?

We believe that pre-trade information is efficiently disseminated to market participants.
Where sufficient market depth and liquidity exists to make aggregation or consolidation desirable there are many commercial services currently exist that provide such services.

Q. 7 What are potential benefits and drawbacks of a pre-trade transparency regime for: a) the wholesale market; and b) the retail market? If you consider that there are drawbacks, please provide suggestions on how these might be mitigated.

Granular pre-trade transparency in illiquid markets where quotes are provided by market participants using their balance sheets to warehouse the inventory may conspire to diminish market functionality. Requiring dealers to publish executable quotes will definitely lead to wider bid/offer spreads and a two-tier or fragmented market where the effective wholesale liquidity may follow equity markets in creating dark pools and regulatory arbitrage.

Q. 8 What key components should a pre-trade transparency framework for corporate bonds have? What pre-trade information should be disclosed?

Dealers and end users should be able to view indicative contributed quotes across a range of dealers and aggregated volumes where there are sufficient numbers of trades to provide anonymity.

Q. 9 Do you think that notional value would be a meaningful piece of information to be made accessible to market participants? Is there any other information that would be relevant to the market?

Publishing notional trade value only becomes meaningful at the point that it also impinges on the ability to execute trades. ~Therefore it would be detrimental to the group of market participants as a whole to make this accessible within the trading period which may suitably anonymise transactions via aggregation. This may be longer than a day for illiquid bonds.

High, Low, Mean, VWAP would be the information that would be relevant to the market as a whole.

Q.10 Do you agree with the initial proposal for the calibration of post-trade transparency for corporate bonds? If not, please provide a rationale and an alternative proposal (including supporting analysis).

Yes we do, but with critical provisos.

The aggregation period may need to be longer than a day in issues/markets where trading is only very ephemeral or low volume.
The aggregate volume and the number of constituent trades throughout the day/publication period would need to be higher then some threshold amount in order to preserve dealer integrity.
It is possible therefore that the calibration can only be applied to certain bonds *a priori* based on their typical market turnover volumes and liquidity.
We would further add an eligibility framework including issuance size (over 1 Bn Eur equiv), maturity (over 12m), and currency (G5).

Q.11 Should other criteria be considered for establishing appropriate post-trade transparency thresholds?

Periodic review should be in built.
Beyond the measures above, there may be certain temporal events that may recalibrate, alter or temporarily suspend the reporting. There needs to be a framework in place to implement such a regime.

Q.12 Given the current structure of the corporate bond market and existing systems, what would be a sensible benchmark for interpreting "as close to real time as possible"?

We note that the experience in the United States with the implementation of TRACE has been uniformly negative to the market liquidity (only tempered by the consequential and contemporaneous increased liquidity in the CDS market feeding back surety to the cash market).
Therefore whilst pre-trade quotations may be disseminated as close to real time as practicable, post trade publication needs to be deferred either until the end of that aggregation period (which may be longer than a day) or until settlement.

Government Bonds (Q4- Q10)

Q. 4 On the basis of your experience, have you perceived a lack of pre-trade transparency either in terms of having access to pre-trade information on Government bonds or in terms of the content of pre-trade transparency information available?

No.
There is substantial pre-trade transparency in this sector to both professional counterparties and also to retail.

Q. 5 In your view, do all potential market participants have access to pre-trade transparency information on Government bonds on equal grounds (for example, retail investors)? Please provide supporting evidence.

IDBs are only regulated to deal with professional counterparties.

Q. 6 Is pre-trade transparency efficiently disseminated to market participants? Should pre-trade information be available on a consolidated basis?

We believe that pre-trade information is efficiently disseminated to all market participants. Quote vendors proliferate, whilst major dealers would all have access to the screens of our member firms which show live market order books.

Q. 7 What are potential benefits and drawbacks of a pre-trade transparency regime for: a) the wholesale market; and b) the retail market? If you consider that there are drawbacks, please provide suggestions on how these might be mitigated.

Granular pre trade transparency in these liquid markets allows for pre-trade information is widely available through all subsets of the market. Regime change would not be beneficial.

Q. 8 What key components should a pre-trade transparency framework for Government bonds have? What pre-trade information should be disclosed?

Not applicable.

Q. 9 Do you think that notional value would be a meaningful piece of information to be made accessible to market participants? Is there any other information that would be relevant to the market?

Not applicable.
High, Low, Mean, VWAP would be the information that would be relevant to the market as a whole.

Q.10 Do you agree with the initial proposal for the calibration of post-trade transparency for Government bonds? If not, please provide a rationale and an alternative proposal (including supporting analysis).

Given the more liquid nature of the government bond market the CESR proposals would be acceptable in most cases.

Q.11 Should other criteria be considered for establishing appropriate post-trade transparency thresholds?

Periodic review should be in built.
Beyond the measures above, there may be certain temporal events that may recalibrate, alter or temporarily suspend the reporting. There needs to be a framework in place to implement such a regime.

Q.12 Given the current structure of the Government bond market and existing systems, what would be a sensible benchmark for interpreting "as close to real time as possible"?

Given the greater deal size in the Government market we note again the very extant sensitivity of liquidity to public disclosure.

Therefore whilst pre-trade quotations may be disseminated as close to real time as practicable, post trade publication needs to be deferred until aggregation at the end of that day or until settlement.

Structured Finance Products (ABS & CDO)

Q. 13 On the basis of your experience, have you perceived a lack of pre-trade transparency in terms of access to and the content of pre-trade information available in the market for ABS?

IDBs deal entirely with eligible counterparties and professional clients who are deemed able to access sufficient pre-trade information in their authorisation.
Our members disseminate prices and volumes via screens and voice as a matter of business.

Q. 14 Is pre-trade transparency information readily available to all potential market participants?

Yes. There are competitive pressures within our industry and between our members to optimise this dissemination.

Q. 15 Is pre-trade information currently available in the ABS market consolidated and effectively disseminated to those market participants who make use of it?

Pre-trade information is consolidated within each of our member firms but not between them. Such competition ensures fairness and integrity.

Q. 16 Which potential benefits and drawbacks of a pre-trade transparency regime do you see for the ABS market? If you see drawbacks, please explain how these might be mitigated.

We don't advocate a new pre-trade transparency regime in ABS or CDO and would note that these are sophisticated and possibly dangerous products for retail investors. Therefore in the light of recent market volatility in the United States, any drawbacks would be associated with the implementation of such an inappropriate "*retail facing*" regime.

Q. 17 Which key components should a pre-trade transparency framework for ABS have? Which pre-trade information should be disclosed?

Not applicable

Q. 18 On the basis of your experience, have you perceived a lack of pre-trade transparency in terms of access to and the content of pre-trade information available in the market for CDOs?

Not applicable since IDB clients and other market participants in the CDO market are for the vast majority dealers and institutional investors with no retail presence.

Q.19 Is pre-trade transparency information readily available to all potential market participants?

Yes. See Q14.

Q. 20 Is pre-trade information currently available in the CDO markets consolidated and effectively disseminated to those market participants who make use of it?

Yes. See Q15.

Q. 21 Which potential benefits and drawbacks of a pre-trade transparency regime do you see for the CDO market? If you see drawbacks, please explain how these might be mitigated.

We don't advocate a new pre-trade transparency regime in ABS or CDO and would note that these are sophisticated and possibly dangerous products for retail investors. Therefore in the light of recent market volatility in the United States, any drawbacks would be associated with the implementation of such an inappropriate "*retail facing*" regime.

Q. 22 Which key components should a pre-trade transparency framework for CDOs, have? Which pre-trade information should be disclosed?

Not applicable since IDB clients and other market participants in the CDO market are for the vast majority dealers and institutional investors with no retail presence.

Q. 23 Which of these criteria to determine the first phase of the phased approach do you consider most relevant? Are there other criteria which should be taken into account?

Not applicable since IDB clients and other market participants in the CDO market are for the vast majority dealers and institutional investors with no retail presence.

Q. 24 Do you have specific ideas on which kind of ABS and which kind of CDOs should be covered by the first phase?

Only with the most liquid and frequently traded ABS and CDOs

Q. 25 Do you consider that it would be appropriate to use the same framework for post-trade transparency for corporate bonds and structured finance products? Please elaborate.

Only given the caveats we have already stated above with respect to the eligibility of each issue and category such that liquidity providers are not impinged.

Q.26 If so, do you agree that the same calibration parameters should be used for structured finance products as for corporate bonds? Or do you think different size and time thresholds should apply?

See Q.25 above. Most products in these categories would be deemed ineligible due to liquidity and bespoke characteristics.

Credit Default Swaps (CDS)

Q27. On the basis of your experience have you perceived a lack of pre-trade transparency both in terms of access to and the content of the information available in the CDS market?

No.
IDBs distribute price and size information across all market participants via both screen and voice. There are many competing platforms creating a plethora of opportunities to access pre trade information. Additionally the IDBs are able to discover further pre trade liquidity upon request from market participants.

Q28. Is pre-trade transparency information readily available to all potential market participants?

Yes. See above.
In addition to the services of our member firms there are many quote vendors competing to display market information.

Q.29 Is pre-trade information currently available in the CDS market consolidated and effectively disseminated to those market participants who make use of it?

Pre-trade information is consolidated within each of our member firms but not between them. Such competition ensures fairness of availability and integrity of data.

Q.30 Which potential benefits and drawbacks of a pre-trade transparency regime for CDS do you see? If you see drawbacks, please explain how these might be mitigated.

Not applicable since IDB clients and other market participants in the CDS market are for the vast majority dealers and institutional investors with no retail presence.

Q.31 Which key components should a pre-trade transparency framework for CDS have? Which pre-trade information should be disclosed?

Not applicable since IDB clients and other market participants in the CDS market are for the vast majority dealers and institutional investors with no retail presence.

Q.32 In your view, would the post-trade transparency calibration parameters (i.e. transaction size thresholds, information to the published and timing of publication) proposed for corporate bonds in Section IV be appropriate for a) Single name CDS? and b) Index CDS? If not, please elaborate the reasons and propose alternative parameters (including justifications).

IDBs match CDS as a name passing broker and therefore only act as arranger. This allows the CDS market trades to be more effectively aggregated than for the Bond markets.
It is however important to recognise the immense heterogeneity within the CDS markets and therefore the differing ability and impact of post trade calibration regimes. Further it is important to note how these factors not only differ across the scope of the market but also with respect to time and market conditions.
As an approximate rule we would suggest that the calibration regime may initially be appropriate for those CDS deemed “Clearing Eligible” such as the major indices and their component names, so long as threshold volumes are being regularly cleared.

Q.33 In your view, should sovereign CDS be included within the post-trade transparency framework for CDS? And if so, should the calibration parameters for single name and sovereign CDS be aligned? If not, please explain why they should be different and propose an alternative approach for sovereign CDS (including justifications).

Yes.

Derivatives (*Interest rate derivatives, Equity derivatives, Commodity derivatives and FOREX derivatives*)

Pre-trade transparency for derivatives

Q. 34 On the basis of your experience have you perceived a lack of pre-trade transparency in terms of access to pre-trade information on a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives and the content of the information regarding these products available in the market?

Noting that IDBs only cover professional clients and eligible counterparties, it is important to stress here that all the classes of derivatives mentioned above are traded only by the wholesale market. Authorisation into these markets is only granted by way of demonstration of an inside knowledge of the products and where and how they trade. As such the notion of a "lack of pre-trade transparency" remains counter intuitive.

IDBs distribute price and size information across all market participants via both screen and voice. There are many competing platforms creating a plethora of opportunities to access pre trade information. Additionally the IDBs are able to discover further pre trade liquidity upon request from market participants.

Q. 35 Is pre-trade transparency readily available to all potential market participants?

Yes, for each of the categories stated above.

Q. 36 Is the pre-trade information currently available in these markets consolidated and effectively disseminated to those market participants who make use of it? If necessary, please specify your answer by product.

Pre-trade information is consolidated within each of our member firms but not between them. Such competition ensures fairness and integrity.

Q. 37 Which potential benefits and drawbacks of a pre-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.

IDBs broker each of these categories of derivatives in the capacity of a "*name passing broker,*" and therefore only act as the arranging agent to the trade.

Whilst it is in the interest of the IDB to gather and broadcast all the pre-trade transparency available, the nature and complexity of these markets and the risk factors behind each trade determine that prices are not latent, but provided upon demand with the quote maker utilising his own balance sheet to facilitate the trade. Each deal will have the risk factors (such as "Delta, Gamma, Vega, Rho, ect") disaggregated, bucketed and managed separately. Thus the concept of pre-trade transparency as imported from the equity and exchange traded market becomes less relevant in these contexts. [see annex 1, 2, 3]

Q. 38 Do you believe that pre-trade transparency would be desirable for some or all types of OTC derivatives (i.e. equity, interest rate, forex and commodity derivatives)? Which key components should a pre-trade transparency framework for any of these above mentioned derivatives have? Which pre-trade information should be disclosed?

No, for the market structure reasons referred to above.

Post-trade transparency for derivatives

Q.39 On the basis of your experience have you perceived a lack of post-trade transparency, both in terms of access to relevant information and the content of this information for any of the following markets: a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives?

Under Article 25 of the MiFID dealers and other trading counterparties are obliged to report transactions privately to their respective home state competent authorities.

Given the very bespoke nature of most OTC derivatives, post trade reporting beyond the trade reporting to national supervisors would add little transparency in itself. Rather it is the disaggregation of the reported risk factors with the trade pricing and the bucketing which adds to market transparency. This is currently done by various market participants and quote vendors in order to build runs and curves across the various relevant dimensions.

On the basis of the experience of our members, who speak to all market participants almost all of the time, there have been no or few comments as to the lack of post-trade transparency.

In the specific case of equity derivatives, the vast majority of the OTC trades are reported through "*BClear*" or otherwise to through the relevant exchanges.

In the specific case of Credit Derivatives, CMA provide data which is sourced from major buy-side firms as they receive pricing from the dealers.

Q.40 Do you believe that additional post-trade transparency would be desirable for all of the above instruments? If not, which ones would benefit from greater post-trade transparency?

No. Again, due to the bespoke and multifactor nature of these instruments, any post trade transparency close to the point of execution would penalise the entity providing the quote and the market liquidity. Trades should be bucketed, aggregated and reported to the public at the end of a suitable aggregation period. This may not be the trade day but longer time frames depending upon the turnover and liquidity in the relevant products.

Strong consideration should be given to the reporting of the risk factors in the buckets which produce the curve pricing, rather than the individual trades. Counterparty credit is evidently one such key factor relevant to pricing; in order to simplify this particular factor, post trade transparency should only apply to those derivatives eligible for, and put up to CCP clearing.

This would require the building of a consolidated reporting framework which may leverage upon the aggregation of deals novated by all the relevant CCPs.

Q.41 Is post-trade transparency readily available to all potential market participants? Does this vary by asset class?

For all the above instruments post trade transparency is less relevant than the pricing factors behind the trades as per Q40 above.

Q.42 Which potential benefits and drawbacks of a post-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.

Drawbacks revolve around the compromising of the bilateral parties to each deal because the risk either is taken on to the balance sheet and mitigated over time in the case of the dealer, or leaves the end user open to particular reset or expiration risks in the case of their hedge position. Increased use of aggregation in reporting and volume weighted average price (VWAP) indices could mitigate some of the risks inherent here as it would remove PIN Risk or liquidity risk in market execution.

It is important that the post-trade transparency regime must adopt an approach that is sensitive to the instruments being transacted, if it is to avoid destroying the very risk-transfer market that it purports to improve.

Q.43 Which are the key components (e.g. qualitative or quantitative criteria) which should be taken into consideration when designing such a post-trade transparency framework?

Post-trade transparency should apply to centrally cleared and novated trades only. This is because of the important effect the credit of both counterparties exerts on both the price and often the structure of each derivative trade. This would avoid the risk of delivering misleading information to the market.

It should be remembered that whilst the market supply of derivatives is limitless, the net market position is always zero. Relative to the market for the underlying therefore, the volume considerations in the derivatives markets are rendered fairly meaningless.

Q.44 Do you think that a post-transparency regime could have some additional valuable externalities in terms of valuation, risk measurement and management, comparability and other uses in price discovering process on related underlying reference instruments?

Given the virtual nature of derivatives markets (all positions always net to zero) and their dependence upon the integrity of the underlying instrument or index; the additional values may lie in the information contained within the aggregate open interest and “basis” deviation from the theoretical values which could message some underlying fundamental information on the [inter-temporal] supply and demand curves [and hence imbalances and risks] within the wider market.

Annex 1: What is an inter-dealer broker?

What is an inter-dealer broker?

The main business of an IDB is to provide access to OTC and/or exchange traded pools of liquidity, across a full range of asset classes and their associated derivatives. Typically, brokerage activity takes place in the wholesale financial markets, which includes cash deposits, financial derivatives, securities, equities, commodities, energy, emissions and credit.

The primary function of a broker is to act as an intermediary through which wholesale market participants can conclude transactions by the bilateral matching of their trading needs with other wholesale market participants having reciprocal interests.

Typically, counterparties within these markets would be wholesale market participants consisting of investment banks, primary dealers, leading regional banks, high volume trading companies, government agencies and fund management firms, and would not include any retail clients as defined under the FSA rules.

Prices, orders and expressions of interest will be communicated across a variety of mediums - often hybrid - including telephone, electronic display screen, or fully electronic trading system (Multilateral Trading Facility ("MTF") as defined by MiFID).

In each market, brokers will communicate to all the counterparties whether bids and offers are 'firm' or 'indicative'. In most cases unless otherwise stipulated during the course of dealing, market quotes provided by brokers represent live, tradable prices based on counterparties' bids and offers and market information then available.

Brokers will endeavour to match the counterparties trading requirement or orders with other trading interests in the market. Normally this means that brokers can only give the counterparty access to their own liquidity internal pools, and will pass prices or orders to and from its other counterparties to its own voice brokers or display these clusters of prices on its own electronic trading systems. In addition, brokers may use "link" brokers with whom they have a commercial relationship in order to extend their reach (for example across geographic lines where one broker may not have a presence) and arrange a trade between their own counterparty and a client of the linked broker.

Brokers, as instructed, will arrange trades on behalf of a counterparty, based either on a price or order that the counterparty has placed with them, or as confirmed by the counterparty following a period of negotiation.

Brokers may utilise price dissemination screens in their role as voice brokers, and illustrate an actual or indicative mid-market or bid or offer price based on actual trading, orders and expressions of interest. While brokers intend to provide counterparties with the most accurate and reflective view of current price levels in all market conditions, it may not always be possible to actually trade at the displayed prices if a corresponding order is not then available due to temporary volatility. Market participants fully understand these nuances of dealing practices.

Unless otherwise communicated to the counterparty before trading, all orders submitted to a broker's MTF platform will be traded on price/time priority. Counterparties will also be able to view full order depth. Execution occurs on the basis of active acceptance of orders in the system submitted by other users. Eligibility, trading methodology, instrument descriptions and credit parameters are all set out in the user terms for the relevant MTF.

Prices are given and trades executed, either excluding brokers' brokerage (i.e. a clean price) or via a net price including commission. Brokerage rates are as agreed between the counterparty and the broker by product, often with volume discounts or other fee discounts based on market making activity.

To facilitate this transaction activity brokers engage their clients on both an electronic and voice basis. In most cases brokers arrange trades on a 'name give-up' basis where the identity of the counterparties is exchanged post-trade. However there are two other brokerage business models: 'matched principal' and 'exchange give-up'. Here is a more detailed description of these three options:

Name Give-Up

The name give-up brokerage model is the traditional model, through which the broker takes on an arranging role in a transaction between two or more counterparties. The broker, through price dissemination, distributes quotes to other market participants showing both price and volume. As outlined above, for voice brokered products these prices and volumes are dependant upon market convention, either firm or indicative levels of interest, and must be confirmed prior to the trade being completed. For electronic products brokered through MTFs, these prices and volumes are typically firm and are traded without further communication.

Once the trade price, volume and terms have been agreed, either through further conversation with the broker or with the direct hit or taking of prices on an MTF, the counterparties' names are disclosed and the broker steps away from the transaction. Bilateral agreements are then enforced between the counterparties and the broker will invoice the brokerage fee on a monthly basis or extract the commission at the point of sale.

Matched Principal

In the matched principal model, the broker facilitates its clients in anonymous trading activity by taking part in a matched transaction as principal, becoming the buyer to the seller and the seller to the buyer. The broker's own credit with its counterparts and the nature of its netting and settlement procedures will determine the amounts that be executed in this manner.

While operating as matched principle the broker will not trade speculatively for a client or for his own book. The trade will only be executed as a result of a firm client order to buy or sell at a set price or size. Once the trade is complete, price, volume and terms are communicated through the broker and back office confirmations.

Similar to the name give-up format, settlement is made between each client based on the market convention with the brokerage fee being either incorporated in the all-in price passed to the client through a disclosed brokerage agreement or through a monthly invoice.

Exchange Give-Up

In addition to name give-up and matched principal brokerage models, brokers can facilitate the trading activity of their clients on derivative exchanges (e.g. LIFFE, Eurex, CME, etc). In this instance the broker may engage in exchange trading in the capacity of an 'Executing Broker' as defined in the FOA's International Uniform Brokerage Execution Services ('Give-Up') Agreement, and give-up the trade to a client's clearer immediately following the execution of the transaction. Under this 'exchange give-up' model the broker is subject to intra-day exposure of this 'agent' position until the trade is accepted by the counterparty. This 'give-up/pick-up' arrangement is standard in all exchange traded products.

Procedurally, upon receiving the relevant price information from the broker, the client will instruct the broker to place an order on the appropriate exchange, either in its own name (if a member of the exchange) or through a third party clearing member or GCM. The broker can provide the client with an indication of the market based on the current price and volume activity on the exchange.

Annex 2: The Value of Interdealer Brokers to Market Infrastructure

The Value of Interdealer Brokers to Market Infrastructure

As outlined above, IDBs are companies that serve as intermediaries which facilitate transactions in the OTC markets between dealers and banks in a variety of financial instruments.

IDBs add value to the markets by:

- Enhancing price discovery and transparency
- Increasing pricing confidence
- Protecting clients' interests
- Providing anonymity and confidentiality
- Managing complex trades
- Facilitating information flow
- Facilitating enhanced liquidity
- Improving market efficiency
- Delivering multi-lateral electronic trading and settlement solutions
- Lowering costs for customers

Price Discovery and Transparency

IDBs facilitate the execution of transactions by providing global pre-trade price discovery in various markets. Prior to execution, an IDB distributes its prices gathered from dealers with market interest in the form of bids and offers through a variety of methods ranging from custom-designed trading platforms to other forms of electronic communications and by voice.

The broker aggregates price information in order to show its dealer clients the best quotes available in the marketplace. Dealers use this information to trade for their own account and to facilitate customer transactions.

The publishing of prices improves price and trade transparency and discovery and with the ultimate goal of bringing multiple buyers and sellers together at one price. Such information is vital in emerging or complex markets that depend on this IDB price transparency not only for trading but also for valuation of portfolios.

Price Confidence

In many markets, especially immature or complex markets, there may be many instances where dealers are not certain that a particular instrument has been priced correctly and so the price is checked with an IDB. The advanced models that the IDBs use and their wealth of experience in a cross section of markets enables them to act as a 'safety' valve for the bank dealer ahead of his quoting or executing a client trade. This value added service is unique to IDBs and not possible on exchanges as IDBs are able to confirm or correct a dealer price as well as have hedge strategies lined up and ready to execute on his behalf in the event that the dealer executes his client trade.

Protecting Clients

One of the most valuable functions of IDBs is their ability to protect dealers from accidental and erroneous trades or even malicious transactions. In their unique position as gatekeepers, intermediaries and facilitators of trades IDBs are able to protect their clients' interests by virtue of a total market overview. Similarly, in cases of unusual market volatility IDBs are preferred because the brokers are rapidly able to change a dealer's quote to match these volatile or gapping market conditions. The re-emergence of voice brokerage services at the expense of electronic trading was extremely evident when post-Lehman volatility reached its peak and dealers sought the protection and price discovery offered by voice brokers.

Anonymity and Confidentiality

An IDB maintains absolute client anonymity during the price discovery process in order to prevent competing dealers from discerning each other's strategies by attempting to monitor the market activities of their competitors. The IDBs thereby prevent prices from being adjusted pre-trade based on the knowledge of participating counterparties. This is in accord with the observance across all the IDBs of the previously referred to Bank of England's NIPs Code."

During price discovery, dealer interactions with IDBs are not revealed to the marketplace. This anonymity reduces the market impact costs associated with the value to the market of the knowledge that a particular dealer is seeking to execute a particular trade.

Managing Complex Trades

Most non-standardised or non-commoditised instruments are traded through the IDB OTC market as these orders enjoy a high level of complexity that may be optimally managed by human interaction and/or the highly sophisticated IDB electronic systems built specifically to function in high velocity, multiple buyer/seller environments. IDBs are able to arrange multi-legged trades and dynamic hedges to simultaneously execute these across multiple instruments and asset classes so as to provide a dealer with a trade that is tailored to his particular requirement or that of the dealer's end-user.

Facilitating information flow

An IDB's role in facilitating the flow of information between dealers is a critical service which both enhances liquidity and results in improved prices for market participants. Pre-trade, IDBs facilitate market information flow in a number of ways. IDBs post and disseminate market information through and their own electronic systems or such market data providers as Reuters and Bloomberg to their dealer clients. By providing anonymity to their dealer clients, IDBs thereby encourage dealers to supply the IDB with market information, and so the IDB is likely to have a more complete composite picture of the market than any one dealer or combination of dealers. Finally, by aggregating this information in conjunction with price quotations, IDBs provide participants with valuable information that reflects the real-time state of the market. IDBs also facilitate post-execution price transparency by reporting trades, volumes and direction. As a result, market confidence levels increase and more market participants are attracted to trade.

Enhancing liquidity

In financial markets there are numerous factors that affect market liquidity ranging from price uncertainty to credit worthiness to availability of an underlying hedge instrument to a lack of available capital due to balance sheet restrictions to temporary disruptions in market behaviour. As IDBs act as agents and provide dealers with quotes from other dealers, they enhance the information available to the market and the market's overall efficiency. Thus, IDBs facilitate trades and ensure a more liquid market. Peer group competition among IDBs means that overall liquidity is further enhanced because there are free flowing, decentralized pools of liquidity which wholesale market participants can access.

IDBs are able to create liquidity where such liquidity did not before exist through their ability to view multiple markets simultaneously across the dealing floor and derive prices from complementary marketplaces. This wide vision enables IDBs to execute cross asset trades and to provide liquidity in an otherwise illiquid market by spreading the trade components against other products which may trade in a more liquid market. Examples of this would be the trading of USD interest rate swaps against US Treasuries where a price in one would generate a price in the other. Another example would be in delta hedging of swaptions where a tradable price on the option would generate an executable price on the swap and vice versa.

Improving Market Efficiency

By definition, in illiquid markets trading activity does not occur with regularity. As the IDBs have real-time knowledge of the market participants, their underlying interests and their trading activity, constant communications with the brokers enables dealers to trade given the smallest window of opportunity. For traders, the timesaving element of working with IDBs and the IDB's ability to execute rapidly will make the difference between executing and missing a trade for dealers and by extension for their customers.

Lowering Costs

By collecting information from dealers on an independent basis, interdealer brokers gather the available liquidity for a particular instrument. This function often serves to make available a sufficient, tradable amount for often illiquid securities. This practice not only creates transactions that would otherwise not occur, the combining of 'odd lots' into 'round lots' serves to lower search costs for dealers. As mentioned above, without IDBs, dealers would be in the position of having to expose their identity to the marketplace as they search to gather and combine amounts in liquid sizes or gather together the various components of a multi-legged transaction. The public disclosure of this information might not only prevent them from operating successfully in the market, it would also serve to impair their bargaining position and directly raise net costs.

Additionally, many trades involve the simultaneous execution of more than one instrument such as a bond against a future or a swap against a bond or a futures cross. IDBs may not charge commission for each of these legs independently but rather may invoice a fee for only one leg thereby saving the dealer a significant amount which he would be able to pass on to his end customer.

Summary observations and recommendations

i. OTC markets have a crucial role to play in all national and international economies alongside and complementary to exchange markets. OTC markets have played a major role in global economic development and have been the provider of solutions that have benefited savers, investors, businesses and governments.

ii. The perception of OTC markets as "unregulated" overlooks that fact that all major market participants are individually regulated and codes of conduct are set by supervisors in most OTC markets.

iii. An overhaul of some areas of the regulatory framework supporting wholesale financial markets is now deemed necessary by both national supervisors, such as the FSA, through the Basel II process, and the CRD. But serious - and perhaps unintended and unfortunate - consequences may well follow if a short-sighted diagnosis of the problem is reached and/or heavy- handed actions are taken in response to the current market turmoil. The impact of these consequences would fall on many retail end users outside wholesale OTC markets, including governments, corporate and retail borrowers and investors.

iv. Many OTC markets may benefit from the wider utilisation of CCP operations. However, the decisions to use such entities should not be mandated but left to the discretion of the end user in order not to increase trading costs, increase hedging and further basis risk, constrain end user cash-flows, compromise end user accounting standards & conventions and diminish market flexibility.

v. The solution to current problems in financial markets does not lie in attempting to mandate the transfer of OTC trading onto exchanges. The OTC markets have traded, and need to continue to trade, separate to and in conjunction with exchange markets for many reasons. OTC markets are both larger in scale than exchange markets and a vital risk management tool and as such their use benefits governments, corporations, investors and individuals worldwide. An exchange solution needlessly grants the exchange a monopoly on trade execution (which is usually accompanied by restricted access to clearing) which thereby leads to increased trading costs and risk and diminished flexibility.

vi. The OTC market has already invested significantly in developing its infrastructure in pre-trade, electronic matching, affirmation and confirmation segments. This infrastructure already contributes hugely to reducing risk and will be continuously enhanced for the benefit of all.

vii. The IDBs are at the forefront of the wider adoption of electronic trading. Whilst we strongly advocate that electronic trading has identical price transparency to voice initiated matching, we note the incorrect, wider legislative and public intuition that it is electronic trading only that enables simpler and faster trade capture, despite totally fungible affirmation, confirmation and supervision of trading activity. It is for commercial and technological reasons that we are confident and committed to the adoption of further electronic trading in more OTC markets going forward, and to simultaneously ensure that the post-trade experience of a voice execution mirrors exactly a fully electronic trade.

viii. The infrastructure developments pioneered by the IDB community will foster quicker settlement cycles in all securities markets. A T+1 settlement cycle for all securities markets should be endorsed.

ix. The IDB community seeks faster and fully automated affirmation/confirmation of all derivatives trades. This affirmation and confirmation of all OTC trades in all markets needs to be accelerated as close as possible to the trade date.

x. The IDB community advocates greater use of pre-booking netting. In many cases, transactions can legally and economically be netted, rather than settled on a gross basis, providing the corresponding benefits of lighter middle and back office flows and more optimal use of capital as gross positions need not be financed.

Annex 3: The Role of Name-Passing Brokers

The Role of Name-Passing Brokers

Introduction

The Financial Services and Markets Act (Regulated Activities) Order 2001 included in Article 25 the activity of "arranging deals in investments" and this was defined as:

1) making arrangements for another person (whether as principal or agent) to buy, sell, subscribe for or underwrite a particular investment which is a Security or a contractually based investment, or an investment of the kind specified by article 86 or 89 so far as is relevant; or

2) making an arrangement with a view to a person who participates in the arrangement buying, selling, subscribing for or underwriting investments falling within 1) above "whether as principal or agent".

Hence it was clear that the name passing broker fell within this activity.

The above activity has not been clearly transposed into MiFID and the purpose of this note is to set out the activity performed by name passing brokers in relation to how this is to be treated under MiFID, with particular focus on whether they are deemed to be conducting the activity of Receivers and Transmitters of orders.

Legislation

According to Recital (20) of Level 1 Directive 2004/39/EC (the "Directive"), a party that brings together two or more investors, culminating in a transaction between those investors, qualifies as the business of reception and transmission of orders.

This would suggest, therefore, that brokers acting in a name passing capacity are receivers and transmitters of orders. However, in carrying out their activities they do not receive and transmit orders for execution. As receivers of orders, they are a sub-section of the "Receiving and Transmitting" grouping and not all rules relating to the Receiving and Transmitting Group are applicable to name-passing brokers.

Best Execution

Article 21 of MiFID requires "that investment firms take all reasonable steps to obtain, when executing client orders, the best possible results for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order".

Article 45 of MiFID Implementation Directive require, when providing the services of Receipt and Transmission of Orders, a firm must "take all reasonable steps to obtain the best possible results for their clients taking into account the factors referred to in article 21.1".

The role of a name passing broker is to provide quotes on request to counterparties in order that such counterparties may enter into a bilateral contract with each other. Therefore, as name passing brokers do not 'execute' transactions, or receive and transmit orders for execution, the WMBA understand that Best Execution is not applicable in these markets.

Furthermore, based on our analysis of the legislation and in accordance with Recital (33) of the Level 1 Directive which states that it is necessary to effect a 'best execution' obligation to ensure investment firms execute client orders on terms most favourable to the client, we do not believe that the name passing broker activity actually falls within the definition of "concluding agreements" as the final details of the trade are agreed between the two counterparts. Name passing brokers neither have contractual nor agency obligations to their clients in the performance of their role and quote prices rather than execute orders.

Furthermore, we would highlight the European Commission's response to CESR on the 19th March 2007. This states with regards to Best Execution, "questions of market practice will help determine whether it is legitimate for clients to rely on the firm". The paper cites, "For example, in the wholesale OTC derivatives and bond markets buyers conventionally "**shop around**" by approaching several dealers for a quote, and in these circumstances there is no expectation between the parties that the dealer chosen by the client will owe best execution".

As name give-up brokers firstly operate in the wholesale markets, secondly provide access to pools of liquidity to allow clients to "shop around" and thirdly, arrange as opposed to execute or transmit transactions for execution, they should not be subject to the Best Execution requirement.

Conclusion

Based on the role of the name passing broker (See Annex 2, Role of an IDB), it is the WMBA's understanding that whilst name passing brokers fall into the generic definition of 'receiver and transmitter of order', they are merely arrangers of transactions and under MiFID do not execute transactions or transmit orders for execution and therefore are not subject to the best execution requirements in article 21 of MiFID.

Annex 4: WMBA EXECUTION POLICY

WMBA EXECUTION POLICY

This Execution Policy is applicable to broker services provided to you by _______________ , and/or any of its relevant group companies, as notified to you from time to time ("Broker").

This Execution Policy should be read in conjunction with the Broker's standard terms of business.

Introduction

When providing a brokerage service to you in relation to financial instruments (as set out in Annex 1), the Broker will take reasonable steps to achieve the best overall trading result for you. This means that the Broker will aim to provide "best execution" subject to and taking into account the nature of your orders, the prices available to the Broker in the market, the nature of the market in question and a reasonable assessment of the sometimes overlapping and conflicting execution factors (which are detailed below).

The Broker's intention is, so far as possible, to exercise consistent standards and operate the same processes across all markets, clients and financial instruments in which the Broker operates. The Broker also intends to provide you and other market participants with access to (where possible) tradable prices on a non-discriminatory basis. However, the diversity in those markets and instruments, what the Broker knows of your own trading intentions, and the kind of orders that you may place, mean that different factors will have to be taken into account in relation to any particular transaction.

Annex 2 to this document provides further detail on the nature of the service the Broker, as an Inter-Dealer Broker (IDB), provides to its clients.

Exemptions from the provision of Best Execution

Notwithstanding the intentions expressed above, the Broker does not undertake to provide "best execution" if you fall within any of the following exemptions:

Eligible Counterparties

- If you are classified as an Eligible Counterparty you will not be entitled to best execution under the UK Financial Services Authority ("FSA"), or equivalent EU rules. This is in line with

Article 24 of MiFID which provides that the best execution obligation under Article 21 will not apply.

Market Practices

- In the wholesale OTC derivatives and bond markets (and for the avoidance of doubt this would include derivatives in Equities, Energy and Commodities) in which the Broker operates (and as recognised by the European Commission) it is normal market practice for buyers and sellers to "shop around" by approaching several brokers/dealers for a quote. In these circumstances there is no expectation between the parties that the broker/dealer chosen will owe best execution.

  As a sophisticated participant in the wholesale markets, unless you advise us to the contrary we will assume that this is your normal trading behaviour.

Transactions arranged in a name passing capacity

- Brokers acting in a name passing capacity (as described in Annex 2) are receivers and transmitters of orders but in carrying out their activities they do not receive and transmit orders for execution. Where orders are not transmitted for execution, the requirement to provide best execution will not apply.

Client Instructions

- Where you provide the Broker with a specific instruction in relation to your entire order, or any particular aspect of your order, including an instruction for your trade to be executed on a particular venue, the Broker will execute the order in accordance with your instructions. However, please note that in following your instructions, the Broker will be deemed to have taken all reasonable steps to provide the best possible result for you in respect of the order, or aspect of the order, covered by your specific instructions,

  Note that when you give an offer, take a bid or place an order on a multilateral trading facility (MTF), the best execution provisions of MiFID will not apply to the operator of the MTF and these obligations will fall on the user of the system. Your order will be classified as a specific instruction and hence the best execution provisions of MiFID will not apply.

Clients

Except in exceptional circumstances, the Broker will only deal with Eligible Counterparties and Professional Clients as defined in MiFID and by the FSA.

Because the Broker always intends to handle orders and expressions of interest in an equitable and consistent manner, once a client is classified as an Eligible Counterparty for the purposes of a particular instrument, that client may not then elect to be re-classified for the purposes of one transaction of a type it customarily undertakes. Exceptional circumstances may be taken into account at the time, with the consent of the Broker (the Broker may decline to provide a service should a reclassification be requested).

Execution Venues

This Execution Policy sets out the venues on which the Broker may transact your order. It has identified those venues on which the Broker will most regularly seek to execute your orders and which the Broker believes offer the best prospects for achieving the best possible results for you, taking into account the execution factors detailed below.

The Broker is able to transact trades on your behalf on any of the following execution venues:

- The Broker's customer base in the over the counter (OTC) markets;
- Any Multilateral Trading Facility (MTF) operated by the Broker*; and*
- Various Exchanges to which the Broker has access and which are listed on the Broker's website.

When selecting the venue on which to transact trades the Broker will take reasonable measures to ensure that the selected venue obtains the best possible trading result for its clients, subject to the following factors:

- In the OTC markets in which the Broker operates, it can only give clients visibility to prices that have been communicated to the Broker by other clients that operate in the same market, accordingly any "best outcome" will solely be within these limits;

- The Broker will provide details of all tradable bids and offers (subject to the other matters referred to below);

- Time availability of prices – in many markets there are lulls and spikes in trading as negotiations align trading interests at different times and different parts of the curve, accordingly the "last traded" price may not always be available or act as a reliable indicator of current price;

- The Broker cannot allow clients to trade in a market unless it is reasonably satisfied that the client (via an agent or otherwise) is operationally capable of settling the relevant trade;

- The Broker cannot control either the cost of credit (credit premium) or credit acceptance between its clients;

- Rates of brokerage will vary between clients, based on agreements and levels of activity.

Execution Factors

In the absence of express instructions from you, the Broker will exercise its own discretion in determining the factors that the Broker needs to take into account for the purpose of providing you with the best possible result.

These execution factors in the wholesale markets in which the Broker operate will include, but are not restricted to, the:

- characteristics of the client;

- size, nature and characteristic of the order;

- likelihood and speed of execution;

- price and costs of execution; and

- exchange settled block trades, or positions larger than standard market size, may be crossed at a particular stage in the trading day or kept anonymous to the majority of market participants; unless otherwise directed, the Broker will only show the price and size to parties that it believes may have an interest in executing or crossing such a position.

Monitoring and review

The Broker will monitor the effectiveness of its order execution arrangements and order execution policy in order to identify and, where appropriate, incorporate any amendments to procedures. The Broker will assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for its clients or whether the Broker needs to make changes to its execution arrangements. The Broker will review its order execution arrangements and order execution policy at least annually or whenever a material change occurs that affects its ability to continue to obtain the best possible result for the execution of client orders on a consistent basis using the venues included in its order execution policy. The Broker will notify you of any material changes to its order execution arrangements or order execution policy as described above by posting the information on the Broker's website.

No Fiduciary Relationship

The Broker's commitment to provide you with "best execution" does not mean that it owes you any fiduciary responsibilities over and above the specific regulatory obligations placed upon it or as may be otherwise contracted between the Broker and yourself. You remain responsible for your own investment decisions and the Broker will not be responsible for any market trading loss you suffer as a result of those decisions.

Annex 4; WMBA/LEBA Members

WMBA/LEBA Members

- BGC Partners
- EBS Group
- GFI Group Inc.
- ICAP plc
- Martin Brokers (UK) Ltd
- Reuters Transaction Services Ltd
- Sterling International Brokers Ltd
- Tradition (UK) Ltd
- Tullett Prebon Ltd
- APX Power UK
- CantorCO2e Ltd
- Evolution Markets Ltd.
- GFI Group, Inc
- ICAP Energy Ltd
- PVM Oil Associates Ltd
- Spectron Group Ltd
- Tradition Financial Services Ltd
- Tullett Prebon Energy Ltd