Deutsche Börse Group

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Response to

European Securities and Markets Authority (ESMA)

Discussion Paper ESMA/2013/1649

ESMA's policy orientations on possible implementing measures under the Market Abuse Regulation

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Deutsche Börse Group response to ESMA discussion paper on possible implementing measures under the Market Abuse Regulation

Introductory remarks

Deutsche Börse Group (DBG) appreciates the opportunity to respond to ESMA's discussion paper.

DBG welcomes the European Commission proposal for a new Market Abuse Regulation (MAR) updating and strengthening the existing framework to ensure market integrity and investor protection. Through the introduction of provisions to prevent market abuse in the form of a regulation, a harmonized EU framework will be established facilitating legal certainty, simplified compliance, and avoidance of regulatory arbitrage. This framework will be further enhanced through the revised Market Abuse Directive (MAD) introducing an EU-wide system of sanctions to deter against market abuse. In order to ensure the objectives of MAD and MAR are fully met in response to market developments in trading platforms and technologies, the legislative package should be developed and implemented closely in parallel with the Markets in Financial Instruments Directive (MiFID) and – Regulation (MiFIR).

DBG supports efficient, fair, orderly and transparent financial markets that meet the needs of well protected and informed investors and provide a source for companies to raise capital and for investors to hedge their portfolios.

We elaborate on questions raised in the ESMA's call for evidence in more detail on the following pages.

Detailed remarks on selected questions

Q40: Which practices do you think are more related to manipulation of benchmarks?

DBG believes that when assessing the potential for a benchmark to be subject to market manipulation a key aspect to consider is the nature of the data that is used to construct that benchmark. It is critical to understand that data for benchmarks is usually being sourced from various different markets with differing degrees of regulation, i.e. transparent, regulated markets in the case of certain benchmarks, or less transparent and less regulated OTC markets in the case of others.

We believe that data in the form of estimates/indications submitted by parties with a beneficial interest in the underlying product or index creates a clear conflict of interest (e.g. their submission of "subjective" data can influence the benchmark used by them as an underlying or reference price for financial exposure within their company). These types of submissions will be more prone to the exploitation of conflicts of interest than data submitted by regulated trading venues where price formation takes places according to pre-defined and transparent rules and under extensive market surveillance, unless those conflicts of interest are managed effectively.

Consequently, DBG distinguishes benchmarks by dividing them into the following three categories:

(a) <u>Category 1</u>: benchmarks based on panel-based data when they are prone to a conflict of interest and experience discretionary powers;
(b) <u>Category 2</u>: benchmarks based primarily on transaction data from OTC markets;
(c) <u>Category 3</u>: benchmarks based primarily on regulated transaction data from regulated markets, and MTFs operated by regulated markets (regulated data).

Cases of misconduct or attempted manipulation of benchmarks in category 1 have been identified by regulators and are currently being investigated. An apparent conflict of interest was at the heart of this misconduct where data providers and those actively investing in index-based financial products were identical and thus beneficiaries of certain index values. The reliability of certain benchmarks in category 2 is also currently under scrutiny for the same reason.

In contrast, benchmarks in category 3 have not been the subject of regulatory concern, nor have the regulatory authorities identified any demonstrable misconduct in relation to their compilation. A key differentiating factor of benchmarks within category 3 is that they are calculated on the basis of a regulated trading venue's transparent data. In particular, regulated markets are required to comply with stringent regulation concerning market integrity, orderly and transparent price formation, the operation of efficient markets and are not permitted to have any trading exposure in their indices or related financial products. Moreover, their compliance with such regulations is subject to close and continuous oversight by the relevant regulatory authorities. It can be considered though, that according to the pending EU COM benchmark regulation proposal, even transaction data from OTC market shall be considered “regulated data” when stemming from an approved reporting arrangement as defined in point (20) of paragraph 1 of Article 2 of [MIFIR] in accordance with mandatory post trade data requirements.

Q42: In your view, what other ways exist to measure order cancellations?

General remark: As stated in III.2.1. 140, a ratio of cancelled orders alone is prone to manipulation due to the fact that it may be offset by executed small volume orders. It is favourable to avoid this by introducing an order-to-trade ratio based on the number of shares. Hence, this kind of manipulation by small volume orders is not possible and, in addition, a combination of the ratio of cancelled orders and a ratio on volume would not be needed. Therewith, DBG proposes an order-to-trade ratio based on number of shares, rather than number of orders and trades. This is currently best practice on German exchanges, as it is set into force within the German HFT Act as of May 2013.

For illustrative reasons, the order-to-trade ratio may be described as follows (please note that the description only refers to Xetra, while a commensurate methodology is applied to Eurex, reflecting the specifics of derivatives markets).

Order-to-trade ratio (OTR):

In this concept the OTR is defined for each trading participant by comparing the volume of inserted orders (which is all insertions, modifications and deletions of orders) to the volume of executed orders in a given financial instrument. The executed volume is multiplied by a factor, therefore this ‘multiplied executed volume’ is considered for the comparison. The OTR requires that the inserted volume must not exceed the ‘multiplied executed volume’ within a calendar month. A special case applies for situations where a market participant has no executions (or only a small number of executions) in an ISIN within a calendar month. This is the case for illiquid instruments, which may not trade for several weeks or even months. In this case, any kind of liquidity provisioning behaviour (e.g., market maker quotation) would constitute a violation of the OTR, because the inserted volume would exceed the ‘multiplied executed volume’, which is zero if no trades take place within a calendar month. In order to prevent this issue, the concept of a ‘floor’ has been introduced. The floor is an ‘allowance’. It allows a market participant to insert a certain volume without violating the OTR, even if he has no executions (or only a small number of executions) in an ISIN within a calendar month. In order to acknowledge the positive liquidity contribution of market makers, these market participants have higher floor allowances than others. The floor is added to the ‘multiplied executed volume’.

Note that the volumes are measured in number of shares, respectively the number of contracts for derivatives, instead of just comparing the number of orders vs. number of trades.

Q48: Do you agree with the approach suggested in relation to OTC trading

As an infrastructure provider and regulated market we support 'Accepted Market Practices' as we allow these practices in our market and have the respective mechanisms in place that also support these practices (e.g. hedging). Additionally, we have further rules to ensure market integrity and a fair use of those well-defined practices.

Below, please find an excerpt of rules and regulations applicable to our derivatives exchanges ensuring a non-abusive behavior and thus, market integrity:

- Exchange rules

  https://www.eurexchange.com/blob/exchange-en/3138-47006/294256/12/data/exchange_en.pdf_ab-29_11_2013.pdf

- Trading Conditions

  https://www.eurexchange.com/blob/exchange-en/3138-136462/294830/4/data/trading_conditions_en_ab-25062013.pdf.pdf)

- Clearing conditions

  https://www.eurexchange.com/blob/exchange-en/3138-136778/238376/37/data/clearing_conditions_en_ab_19_12_2013.pdf.pdf

- Conditions for Utilization of the OTC Trade Entry Facilities
  https://www.eurexchange.com/blob/exchange-en/3138-47006/112770/19/data/otc_conditions_en.pdf_ab-2013_10_28.pdf

- Mistrade Regulations

  https://www.eurexchange.com/blob/exchange-en/3138-47006/112874/2/data/mistrade_en.pdf.pdf

Q70: Do you agree with this general approach? If not, please provide an explanation.

We wish to highlight the need for clarity with regard to the application of articles 5 and 12 in relation to disclosure requirements for issuers.

DBG supports the aim of achieving the highest level of information disclosure. In the wake of the ongoing economic and financial crisis, we support the work of the G20 to strengthen financial supervision and regulation and to build a framework of internationally agreed high-level standards. We support the Commission proposal to maintain the highest level of transparency and disclosure requirements for European markets across all asset classes in line with the Prospectus and Transparency Directives. This is vital to ensure investor protection.

It is important to consider the limited means of SMEs to fulfil the same requirements as Big Caps. Therefore it is crucial to define exemptions on SMEs wherever appropriate.

It is imperative that rules against insider dealing cannot be circumvented by trading in derivatives.

Q90: Do you agree on the proposal to put in place an internal system/process whereby the relevant information is recorded and available to facilitate the effective fulfilment of the requirement, or do you see other possibilities to fulfil the obligation?

The exemption on drawing up an insider list should not be limited only to SME Growth Markets. Regulated Markets and MTF where SME's instruments are traded must also be able to avail of this exemption in order to have a level playing field.

We trust you would have found these comments useful and remain at your disposal for further discussion. Should you have any questions please do not hesitate to contact:

Dr. Torsten Schaper
Head of Political Analysis
Deutsche Börse AG
Torsten.Schaper@deutsche-boerse.com
++49(0)69-211-15005