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CESR's Responses to Questions 1-14 and 19 of the European Commission Request for Additional Information in Relation to the Review of MiFID

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Executive Summary

CESR provides factual information to Questions 2, 3, 5, 7 and 14 of the Commission request for additional information where it was requested to provide data about EEA regulators' experience on the pre-trade transparency requirements for RMs and MTFs (Table 1 of Annex II of the MiFID Implementing Regulation (EC) No 1287/2006 of 10 August 2010; standard market sizes (Table 3 of Annex II of MiFID Implementing Regulation No 1287/2006); depositary receipts, exchange traded funds, preference shares and certificates; trading activity involving systematic internalisers and sources of pre- and post-trade information (in particular, through electronic systems) for corporate bonds, structured finance products, CDS, interest rate derivatives, equity derivatives, foreign exchange derivatives and commodity derivatives.

Additionally, in responding to Questions 4, 6, 8, 9 and 10, CESR provides complementary information to the one already published in CESR's Technical Advice in the Context of the MiFID Review, Equity Markets (Ref. CESR/10-802) and Non-Equity Markets Transparency (Ref. CESR/10-799) in relation to the following topics: supervisory experience as regards the eventual problems in relation to the definition of a liquid share (Article 22 of the MiFID Implementing Regulation No 1287/2006); organisational requirements for regulated markets and MTFs; transparency for corporate bonds, structured finance products, CDS, and derivatives (and in particular on pre-trade transparency).

CESR also provides its policy views on the following questions on transaction and position reporting and position limits:

Q11(a) How to arrange the flow of information on transaction and position reporting

CESR suggests defining a new position reporting regime through trade repositories (TRs), as foreseen by EMIR, and in the MiFID review recognising TRs as reporting mechanisms through which investment firms will be able to fulfil their transaction reporting obligations, to the extent that TRs will be able to record all the necessary fields to comply with the transaction reporting obligation.

In line with the EMIR proposal, position reporting will be conducted through TRs and, when they will not be able to record the details of the contracts, directly to regulators. CESR will soon start the necessary work for the definition of the technical standards in this respect, in particular for the identification of the relevant fields in both cases.

Q11(b):Other purposes of transaction and position reporting apart from detecting and pursuing cases of market abuse

There are a number of additional purposes of how information on transaction and position reporting might be used. They include among others monitoring compliance with general MiFID provisions, detecting possible risks for market integrity and stability, identifying the relevant contracts for the purpose of the clearing obligation, identifying the systemically relevant counterparties, enforcing the clearing obligation and gathering intelligence on the new market trends.

Q11(c): CESR members' experiences with transaction reporting arrangements

CESR members expressed general satisfaction with the local arrangements put in place in each jurisdiction. Therefore, no major concerns or proposals for amendments were made.

Q12(a): Existing position reporting arrangements in Members States

Commodity position reporting is currently implemented in the Member States of three CESR members. Relevant obligations arise either from the local legislative provisions or are the result of

historical arrangements.

Q12(b): Position reporting

There is widespread support for a system of position reporting to regulators. Position information is highly valuable for commodities market monitoring and in investigations, because typical abusive behaviour in commodities markets commonly emanates from exploitation of dominant positions. Having a history of how positions have been built up is highly valuable to regulators in understanding market behaviours. It can also be useful for assessing systemic risk and for prudential regulation. Ideally the information should cover exchange and OTC markets, to give a whole market view. Technically, ways to include exchanges, central counterparties and trade repositories in the position reporting system need to be explored. The entry into force of EMIR will indeed improve substantially the information on positions in OTC derivatives.

Q12(c): Breakdown of data by type of trader

There is considerable benefit for regulators receiving this type of information, which can be used to understand financial firms' business models and overall exposures relative to other market users. It could also be used to underpin a system of aggregate open interest reporting to the market, similar to CFTC's Commitment of Trader reports[1].

Q12(d): Position limits

There is little evidence so far to suggest that markets where position limits have operated for the life of the derivative contract have been any less volatile than those which have not. Nor is there sufficient evidence so far that position limits can systematically be used to limit the impact that significant positions may have on the prices markets generate. Accordingly, it remains to be further assessed whether or not position limits are suited to achieving the objectives of reducing volatility or limiting the impact that large positions may have on market prices. The key objectives for financial regulators should therefore remain the maintenance of orderly markets and combating market manipulation. The Commission should in CESR's view focus on analysing whether exchanges/regulators have sufficiently extensive set of powers to manage positions across the entire life of commodity derivatives market contract curves setting up a harmonised set of powers for exchanges/regulators in European legislation and considering whether there is a need for further harmonisation in the way those powers are actually implemented across EU commodity derivatives markets.

Q13: Extending the new reporting system to MiFID Article 2(1)(i) and (k) firms

There are in existence already significant alternative reporting methods through which regulators can obtain information on these MiFID exempted firms. These include reporting through regulated intermediaries and reporting of exchange based transactions through market operators. However, extending a new reporting system of transaction and position information to these firms would have the benefits of standardisation of reports and would afford regulators a "whole market" view. In the future, regulators may also receive relevant data on commodities markets positions of firms exempted from MiFID via trade repositories. In view of the fact that EMIR defines non-financial counterparties as those non-covered by MiFID, CRD, Solvency II, etc. it will automatically exclude from the position reporting obligation MiFID exempted firms, with the risk of losing important pieces of information, in particular when contracts are concluded between two exempted firms. Depending on the actual application of the reporting obligation to non-financial firms, which is related to the level of information threshold, regulators will have a more or less 'full picture' of the OTC market.

[1] For more information on the CFTC's Commitment of Trader (COT) reports see http://www.cftc.gov/marketreports/commitmentsoftraders/index.htm.

Question 1: Please share your supervisory experience as regards any problems with the definition of a transaction for the purpose of Regulation 1287/2006.

See CESR's Technical Advice to the European Commission in the context of the MiFID Review: Transaction Reporting (CESR/10-808).

Question 2: Please share your supervisory experience as regards any problems in relation to Table 1 of Annex II of regulation 1287/2006, defining the information to be made public by MTFs and regulated markets according to Article 17 of the same regulation.

CESR members have not experienced particular difficulties with the application of Table 1 of Annex II in their supervisory practice. The description of the different systems therefore seems to be still valid and the definition of the information to be made public by RMs and MTFs seems to be still adequate.

Question 3: In the context of the work on systematic internalisers currently carried out by CESR, please share your supervisory experience as regards any problems in relation to Table 3 of Annex II of regulation 1287/2006, defining the standard market size.

In order to receive views of market participants on the adequacy of the definition of 'standard market size', CESR included a specific question in this regard in its Consultation Paper on MiFID Equity Markets Review (Ref. CESR/10-394)[2].

The majority of respondents have not experienced any difficulty with this definition. Those respondents who emphasised specific concerns with the definition in Table 3 of Annex II indicated a need to reflect more accurately the rapidly changing trading environment and sizes of transactions. In this respect, it was suggested that the SMS should be assessed on a more frequent basis.

CESR has made the following observations regarding the number of liquid shares, the evolution of the AVT and the allocation of SMS in the AVT buckets included in Table 3 of Annex II over the last three years. The data in table 1 and graph 1 below is based on the data published in the MiFID database on the CESR website[3].

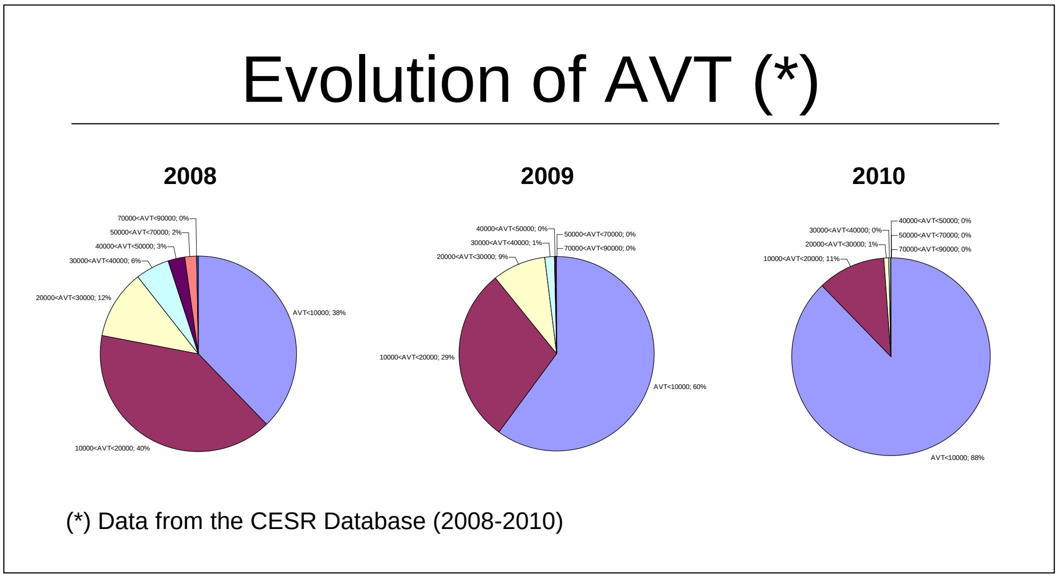
[2] See question 15 of the Consultation Paper – CESR technical advice to the European Commission in the Context of the MiFID Review – Equity Markets, 13 April 2010 (Ref.: CESR/10-394), p.15, available at: http://www.cesr-eu.org/popup2.php?id=6548

[3] See MiFID database at http://mifiddatabase.cesr.eu/.

Table 1: Amount of shares falling in each bucket in Table 3 of Annex II in 2008, 2009 and 2010

Year	Liquid Shares	AVT	AVT<10000	10000<AVT<20000	20000<AVT<30000	30000<AVT<40000	40000<AVT<50000	50000<AVT<70000	70000<AVT<90000
2008	1.004	15.483	38%	40%	12%	6%	3%	2%	0%
2009	742	10.653	60%	29%	9%	1%	0%	0%	0%
2010	732	6.221	88%	11%	1%	0%	0%	0%	0%

Graph 1: Amount of shares falling in each bucket in Table 3 of Annex II in 2008, 2009 and 2010



The Commission may wish to further study this development and the appropriateness of the buckets of the SMS table in the framework of the MiFID review and/or introduce more flexibility in the MiFID Implementing Regulation by allowing ESMA to adjust the SMS table, if necessary, by issuing binding technical standards.

Question 4: In the context of the work on systematic internalisers currently carried out by CESR, please share your supervisory experience as regards any problems in relation to the definition of a liquid share, as set out in Article 22 of Regulation 1287/2006.

Article 22(1) of the MiFID Implementing Regulation specifies the conditions for determining liquid shares for the purposes of the SI-regime in Article 27. In particular, it sets the conditions which must be met before a share admitted to trading on a regulated market can be considered to have a liquid market. In order to be liquid, a share must be traded daily and have a free float of not less than EUR 500 million, and one of the following conditions must be satisfied:

a. the average daily number of transactions must not be less than 500; or
b. the average daily turnover for the share must not be less than EUR 2 million.

In respect of shares for which they are the most relevant market, Member States are permitted to specify by public notice *that both conditions are to apply*. Up to date, only a limited number of Member States have exercised this discretion.

CESR has not experienced any difficulties with this definition or received complaints that the definition of liquidity itself would be inappropriate for determining liquid shares for the purposes of the systematic internaliser regime. However, CESR considered that the use of discretions by some Member States but not by others may lead to deviations in the determination of a liquid share and may thus influence the scope of application of the SI-regime under Article 27 of MiFID. CESR therefore consulted in its MiFID Equity Markets Review CP[4] on the question whether the discretion should be deleted and, if considered desirable, what the future harmonised criteria for the definition of a liquid share should be used: both criteria (a) and (b) or only one of the two criteria.

Majority of respondents saw advantage in having a unique definition for liquid shares and a broad majority of the respondents preferred to apply both conditions a) and b). As reasons for applying both criteria it was mentioned that volatility and liquidity are not absolute concepts. They rather depend on specific markets and market situations. According to another respondent, any definition based on the average daily number of transactions is so dependent on the trend in frictional costs that setting a threshold based on current market conditions may soon prove to be outdated and irrelevant. The same would apply to average daily turnover.

Since this preference expressed in the responses to the CP would result in a significant change to the population of shares considered liquid, particularly for smaller EEA countries, CESR recommended in its Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets (Ref. CESR/10-802) that the existing discretion be retained[5].

CESR members have however observed difficulties in limited circumstances with the calculation of the free float in accordance with the requirements in Article 22(4) of the MiFID Implementing Regulation when calculating the free float in line with Article 33(1)(c) of the MiFID Implementing Regulation for purposes of the MiFID database. In particular, the exemption 'unless such a holding is held by a collective investment undertaking or a pension fund' is considered difficult to apply in practice. It could therefore be considered to delete this exemption for practical reasons.

Question 5: In the context of the work currently undertaken by CESR on transparency for instruments similar to shares, please provide information about the number of trades as well as the turnover per Member State for depository receipts, exchange traded funds, preference shares and certificates.

In order to answer this question, CESR has prepared a questionnaire on trading of depositary receipts and 'certificates' to which all CESR members were asked to respond. The results are summarised below and the details for each Member State are provided in Table 2. Please note that the figures provided by Luxemburg, and thus the aggregate calculations on DRs including this data, are confidential information.
The instruments covered by the exercise were those defined in CESR's technical advice on MiFID Equity Markets Review (Ref. CESR/10-802)[6]:

1. Depositary receipts (DRs) are negotiable securities that represent ownership of a given number of a company's shares and can be listed and traded independently from the underlying securities.

[4] See questions 47 to 49 of the Consultation Paper – CESR technical advice to the European Commission in the Context of the MiFID Review – Equity Markets, 13 April 2010 (Ref.: CESR/10-394), p.30 et seq, available at: http://www.cesr-eu.org/popup2.php?id=6548

[5] CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets, 29 July 2010 (CESR/10-802), p. 38, available at: http://www.cesr-eu.org/popup2.php?id=7004.

[6] For details see http://www.cesr-eu.org/popup2.php?id=7004.

This includes all forms of DRs listed and traded on EU RMs, such as Global Depositary Receipts (GDRs) and American Depositary Receipts (ADRs).

2. 'Certificates' are securities issued by a company whose holders rank above ordinary shareholders but below unsecured debt holders for the repayment of their investment in the company. These securities either do not have voting rights, or have voting rights that are less than those of ordinary shareholders on a unit-by-unit basis. They may pay a fixed coupon or a higher dividend than ordinary shares, and shareholders have the right to receive dividends ahead of ordinary shareholders in the company. In some jurisdictions these instruments are considered to be shares and are therefore already included in the MiFID transparency regime.

Since 'certificates' as defined in the CESR advice only exist in certain jurisdictions or are already considered as shares (and included as such in the national transparency regime and the MiFID database), the columns on 'certificates' were only filled by CESR members in whose Member States these instruments exist and are not yet considered to be covered by the MiFID transparency regime.

In order to evaluate the data requested by the Commission on trades and turnover in a meaningful way, CESR also gathered the number of DRs and 'certificates' admitted to trading on RMs in the EEA.

The data covers a time period of Q1 and Q2 2010 as this will provide an idea about the current market structure in the EEA and liquidity of these instruments. Data on the turnover is provided in millions of Euros. The data does not extend to OTC trades of DRs and 'certificates'.

All CESR members answered to CESR's data request on DRs and 'certificates'.

199 DRs are admitted to trading on RMs in 9 jurisdictions[7]. In Q1 and Q2 of 2010 more than 3.5 million transactions took place in DRs on RMs and MTFs in Europe with a turnover of more than 109 billion Euros. In 4 jurisdictions, DRs admitted to trading on a RM are already included in CESR's MiFID Database for shares[8].

In 10 jurisdictions, 'certificates' are admitted to trading on a RM. In 7 jurisdictions these 'certificates' are considered to be shares and are as such already included in the MiFID database. An extension of the MiFID transparency regime to 'certificates' would therefore lead to 370 additional equity-like 'certificates' in the MiFID database. In Q1 and Q2 of 2010, more than 7500 transactions with a turnover of about 525 million Euros were executed on RMs and MTFs in these 370 'certificates'.

[7] Since information provided by the CSSF is not publishable, this information does not include data from Luxemburg.

[8] Luxemburg considers the instruments named as DRs in its jurisdiction as shares and accordingly includes them in CESR's MiFID Database.

Table 2: Number of DRs and certificates, number of trade, turnover

		Depositary Receipts			Certificates		
		Number of Instruments	Trading		Number of Instruments	Trading	
Country	Competent Authority / Country	Total number of instruments admitted to trading on RMs	Number of Transactions (on RM and MTFs)	Turnover (on RM and MTFs)	Total number of instruments admitted to trading on RMs	Number of Transactions (on RM and MTFs)	Turnover (on RM and MTFs)
BELGIUM	CBFA	21	28267	129.516	0	n/a	n/a
BULGARIA	FSC	0	n/a	n/a	0	n/a	n/a
CZECH REPUBLIC	CNB	0	n/a	n/a	0	n/a	n/a
DENMARK	Finanstilsynet	0	n/a	n/a	46	1983	60.113
GERMANY	BaFin	8*	8210	59.450	*	n/a	n/a
ESTONIA	Finants-inspektsioon	0	n/a	n/a	0	n/a	n/a
GREECE	CMC	1	689	0.167	0	n/a	n/a
SPAIN	CNMV	0	n/a	n/a	0	n/a	n/a
FRANCE	AMF	5*	292536	2162.448	*	n/a	n/a
IRELAND	Financial Regulator	0	n/a	n/a	*	n/a	n/a
ICELAND	Financial Supervisory Authority	1	203	0.937	0	n/a	n/a
ITALY	Consob	0	n/a	n/a	*	n/a	n/a
CYPRUS	Cysec	0	n/a	n/a	0	n/a	n/a
LATVIA	FKTK	0	n/a	n/a	0	n/a	n/a
LITHUANIA	Lithuanian Securities Commission	0	n/a	n/a	0	n/a	n/a
LUXEMBURG	CSSF***						
HUNGARY	PSZAF	0	n/a	n/a	1	2	0.016
MALTA	MFSA	0	n/a	n/a	0	n/a	n/a
NETHER-LANDS	AFM	0	n/a	n/a	*	n/a	n/a
NORWAY	Finanstilsynet	0	n/a	n/a	0	n/a	n/a
AUSTRIA	FMA	1	5094	18.478	323	5552	465.741
POLAND	FSA	0	n/a	n/a	*	n/a	n/a
PORTUGAL	CMVM	0	n/a	n/a	*	n/a	n/a
ROMANIA	CNVM	0	n/a	n/a	0	n/a	n/a
SLOVENIA	Securities Market Agency	0	n/a	n/a	0	n/a	n/a
SLOVAK REPUBLIK	National Bank of Slovakia	0	n/a	n/a	0	n/a	n/a
FINLAND	Fin FSA	1	124321	1295.400	0	n/a	n/a
SWEDEN	Finansinspektio nen	12*	1099806	9708.000	0	n/a	n/a

UK	FSA	149	2031153	95 704.117	0	n/a	n/a

* DRs or 'certificates' (as defined in CESR's advice) admitted to trading on a RM in these jurisdictions are already included in CESR's MiFID database for shares.

*** The information provided by CSSF is not publishable.

CESR referred to Spanish 'participationes preferentes' only in the questions on transparency of equity-like products in the Consultation Paper on MiFID Equity Market Review and has proposed in its final advice on non-equity transparency to include Spanish 'participationes preferentes' in the post-trade transparency regime for corporate bonds due to their special structure and secondary trading in Spain. A common definition of 'preference shares' has therefore not been developed. Since the term 'preference shares' is interpreted very differently in various Member States and it is difficult to exactly define which instruments would be similar to the Spanish 'participationes preferentes', it seems to be of limited value to collect data about instruments which are not considered as equity-like and not clearly defined. Against this background, CESR will not answer the question regarding 'preference shares' and has also not collected data on Spanish 'participationes preferentes' at this stage.

As regards Exchange Traded Funds (ETFs), i.e. open-ended funds which are admitted to trading on RMs and enable investors to gain exposure to equity and fixed income, there is quite a lot of information on the number of ETFs and turnover on the most important trading venues for ETFs publicly available. Since the number of ETFs admitted to trading on a RM is very large, the collection on trades and turnover including all OTC trading of ETFs by CESR members could have been very burdensome. However, the additional value to publicly available information would be limited. CESR will therefore answer the questions on ETFs on the basis of and with reference to publicly available data.

At the end of Q2 2010 the European ETF industry had 961 ETFs with 2,979 listings, assets of US$ 218,0 Bn, from 35 providers on 18 exchanges. Since the beginning of 2010, the number of ETFs increased by 16,3 % with 135 new ETFs launched. The top 100 ETFs, out of 961, account for 67,2 % of European ETF assets under management (AUM). Since the beginning of the year, the average daily trading volume in US dollars increased by 14,8 % to US$ 2,6 Bn[9].

Blackrock[10], for example, provides a list of ETF listings by exchange in Europe (as at the end of May 2010) which includes data on 'number of primary ETFs', 'number of ETFs', 'AUM' and '20 day ADV'[11], a full list of ETFs listed in Europe[12] and figures on turnover in ETFs on each European exchange (and the reported OTC trades) and the respective market share of these venues (or of the reported OTC trades)[13]. According to this data, the total turnover on all European exchanges and the reported OTC trades in January 2010 was EUR 40,924.6m, the average daily turnover being EUR 2,048.4m[14].

Exchanges like the London Stock Exchange also publish monthly statistics on turnover and/or trades in ETFs on their exchanges[15]. Yearly statistics on turnover in each ETF listed on the exchange are also often provided by exchanges such as Deutsche Börse[16].

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9 Blackrock, ETF Landscape, Industry Highlights (end of Q2 2010), p.7.

10 For all reports by Blackrock see http://uk.ishares.com/en/pc/about/etf-landscape/publications?pt=false.

11 See Blackrock, ETF Landscape, Global Handbook (Q2 2010), p. 31.

12 See Blackrock, ETF Landscape, Global Handbook (Q2 2010), p. 32 -113.

13 See Blackrock, ETF Landscape, Celebrating 10 Years of ETFs in Europe, (April 2010), p.22.

14 See Blackrock, ETF Landscape, Celebrating 10 Years of ETFs in Europe, (April 2010), p.22.

15 For the June 2010 statistics of the LSE see http://www.londonstockexchange.com/statistics/specialist-issues/etfs-etps/jun-10.pdf; for June 2010 statistics of Deutsche Börse see http://deutsche-boerse.com/dbag/dispatch/en/notescontent/gdb_navigation/trading/60_downloads/200_statistics/500_monthly_comparison_etf/INTEGRATE/xtf_statistic?notesDoc=/maincontent/KIR+XTF+Monatsvergleich&expand=1 and http://deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/KIR+Web+Publikationen+E/CPOL-87ZCQM/$FILE/XTF_Q2_2010_e_v1.pdf?OpenElement.

Question 6: In relation to CESR work to identify possible differences in organisational requirements between regulated markets and MTFs, please provide details of any differences that are identified.

While the MiFID's organisational provisions governing RMs and MTFs are to a large extent similar, RMs have raised concerns in the past that they are subject to more stringent – and costly – regulatory requirements than their MTF competitors.

CESR has therefore analysed the details of the respective requirements in MiFID and identified one key difference between requirements for RMs and MTFs operated by investment firms, which may be a potential source of unlevel playing field. The concept of "proportionate approach"[17] is laid down in organisational requirements applicable to MTFs and the discretion that may be attached to such test of "proportionality" by competent authorities may lead to less stringent requirements for new MTFs. To provide more clarity that RMs and MTFs should be subject to the same organisational requirements as regards the operation of their trading platform, CESR recommended in its Technical Advice on MiFID Equity Markets Review[18] an extension of requirements for RMs under Article 39(a) to (c) of MiFID to investment firms or market operators operating an MTF.

Apart from this difference in requirements, there are also other organisational requirements in MiFID which differ:

- MTFs operated by investment firms or market operators are covered by Article 14 of MiFID and have to comply with organisational requirements for investment firms under Article 13 of MiFID in addition to specific requirements in Article 14. Article 13 of MiFID sets out very detailed organisational requirements for investment firms further specified in chapter II of the MiFID Implementing Directive. At the face of it, these requirements are far more detailed than Article 39 of MiFID which is laying down organisational requirements for RMs. However, not all organisational requirements for investment firms in the MiFID Implementing Regulation are relevant for the operation of an MTF since they rather govern the relationship between the investment firm and its clients. Comparing the requirements is also difficult because the Implementing Directive allows for a certain calibration of the requirements depending on the 'nature, scale and complexity of the business of the firm and the nature and range of investment services and activities'.
- One obvious example for organisational requirements relevant for MTFs are outsourcing requirements in Article 13(5) of MiFID and Articles 13 to 15 of the MiFID Implementing Directive. There are no such requirements for RMs in Article 39 of MiFID although in practice national requirements for outsourcing by RMs exist.

It could therefore be considered to establish a set of the same formal organisational requirements for RMs and MTFs, be they operated by investment firms or market operators (e.g. by developing Level 2 measures under Article 39 of MiFID which would be suitable for operators of RMs and MTFs).

Where an investment firm operates an MTF and provides additional investment services, conflicts of interest may arise between the function of operating the MTF and the provision of other investment services. Investment firms therefore may require additional organisational requirements to address any issues that may arise from this specific situation (for example through appropriate governance

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16 See Deutsche Börse Group, Factbook 2009, p. 15 to 20 at http://deutsche-boerse.com/INTERNET/IP/ip_stats.nsf/(KIR+Factbook+Kassamarkt+E)/407B2EB81C10C693C12577270052CF51/$FILE/Factbook_2009_e.pdf?OpenElement

17 Article 13(4) in MiFID says that an investment firm shall take reasonable steps to ensure continuity and regularity in the performance of investment services and activities. To this end the investment firm shall employ appropriate and proportionate systems, resources and procedures.

18 See CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets, 29 July 2010 (CESR/10-802), p. 34, available at: http://www.cesr-eu.org/popup2.php?id=7004

structures and conflicts of interest policies) when implementing organisational requirements in practice.

Question 7: In the context of the work currently carried out by CESR to review systematic internaliser requirements, please provide figures for the total trading activity currently involving systematic internalisers. If any changes to the definition of a systematic internaliser are proposed, please provide estimates of the additional trading that would be covered as a result of the changes.

In order to answer the Commission's question on figures for the total trading activity currently involving SIs, CESR members have addressed all investment firms currently operating as systematic internalisers (SIs) which are included in the MiFID database[19] to provide with the following data concerning Q1 and Q2 2010: number of shares included in the investment firms' systematic internalisation service in Q1 and Q2 2010, number of shares traded at least once in the respective time periods, the aggregate number of trades executed in these shares and the aggregate value of these trades, the value of trades of a size below Standard Market Size (as defined in table 3 of Annex II of the MiFID Implementing Regulation) executed under their SI services as a percentage of the total value of trades executed under their SI services in shares admitted to trading on a RM in the EEA, the proportion of SI service in shares admitted to trading on a RM in the EEA provided to retail clients, in terms of the percentage of retail clients in comparison to all clients and value of trading with retail clients in comparison to value of trading with all clients and the value of trades executed under their SI services as a percentage of the total trading in shares admitted to trading on an EEA regulated market executed to satisfy client orders, whether over-the-counter, on a regulated market or on an MTF.

At the time of preparing this response, there are 12 registered SIs. According to the data provided by their competent authorities, the total number of shares traded under the SI services was 2547 (which may include the same shares trades by different investment firms), which were almost all traded at least once during the second quarter of 2010. When attention is paid to the number of trades executed, a significant increase can be noticed from Q1 to Q2 2010, reaching an aggregated number of 2,823,681 transactions with a total value of more than 83 billion Euros in the second quarter.

The number of shares for which the SI service is provided by a particular investment firm ranges from 1 to 683, but the majority of the firms provide this service for more than 400 shares. In the majority of firms the number of shares has remained stable or slightly decreased from the first to the second quarter 2010.

The number of trades executed under this service in Q2 2010 ranges from 1285 to more than 1,500,000 transactions. There is not a clear pattern in this regard from Q1 to Q2 2010, since a small majority of firms experiment an increase in the number of transactions, whilst many others see these transactions reduced.

The value of these transactions shows significant differences between firms ranging from 7 million Euros to more than 13 billion Euros in Q2 2010.

Regarding the percentage of trades below standard market size in relation to the firms' total SI trading activity in Q2 2010, the responses range from 2.9% to 69%. The majority of responses received indicate that these trades represent between 14% and 48% of the total SI trading activity. It is important to highlight that only two firms report a significant increase of them, for the others it remains flat or they report a small decrease.

[19] See the list of systematic internalisers in the EEA at: http://mifiddatabase.cesr.eu/Index.aspx?sectionlinks_id=16&language=0&pageName=MiFIDSystematicSearch&subsection_id=0

Retail investors hardly make use of this service according to the information provided except in three cases where retail clients represent the main group of clients. The outcome of the survey on the percentage of retail business relative to total SI business shows exactly the same results.

CESR asked investment firms providing this service about the value of trades executed under their SI services as a percentage of their total trading in shares admitted to trading on an EEA regulated market executed to satisfy client orders, whether over-the-counter, on a regulated market or on an MTF. Only four firms informed of a percentage above 10%, reaching 32% in the highest case.

Taking into account that CESR has not proposed significant changes to the definition of systematic internaliser[20] and that the answer to the second part of the question would require estimating the impact of the proposed measures on investment firms' behaviour, it does not seem to be necessary to answer this part of the question.

Question 8: How does CESR envisage achieving further transparency in line with its recommendations in the CESR report on Transparency of Corporate Bond, Structured Finance Products and Credit Derivative Markets?

Please see CESR's Report on Transparency of corporate bond, structured finance product and credit derivatives markets (Ref. CESR/09-348) and CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-Equity Markets Transparency (Ref. CESR/10-799) (from now on, the Technical Advice).

For example

Question 8(a): Should the requirements apply by financial instrument regardless of where the trade is executed (regulated market, MTF, systematic internaliser, or OTC) based on qualitative and/or on quantitative grounds? Qualitative criteria could include, for example, whether a bond has been issued with a prospectus, or whether a derivative is clearable. Quantitative criteria could include, for example, bonds with a certain issue size, or instruments with an average daily turnover above a certain threshold

In developing the advice provided in CESR Report on Non-Equity Markets Transparency (Ref. CESR/09-348), the Technical Advice clarifies that the proposed post-trade transparency regime should be applicable to corporate and public bonds for which a prospectus has been published (i.e. including all corporate and public bonds admitted to trading on a regulated market) or which are admitted to trading on an MTF, regardless where the trade has been executed: on a regulated market, an MTF or by investment firms trading OTC. The calibration of the proposed post-trade transparency regimes for corporate and public bonds is based on quantitative criteria, i.e. average transaction size.

In relation to structured finance products (ABS and CDOs), CESR Report on Non-Equity Markets Transparency (Ref. CESR/09-348) proposed a phased approach so that the regime would gradually apply to all ABS and CDOs commonly considered as standardised. This proposal has been developed in the Technical Advice, explaining that in this context "standardised" should be considered as all ABS and CDOs for which a prospectus has been published (i.e. including all ABS and CDOs admitted to trading on EEA regulated markets) or which are admitted to trading on an MTF. The proposed post-trade transparency regime should be applicable to these instruments regardless

[20] See paragraph 90 of the CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets, 29 July 2010 (CESR/10-802), p. 20, available at: http://www.cesr-eu.org/popup2.php?id=7004

whether the trade has been executed on a regulated market, an MTF or by investment firms trading OTC. The calibration of the regime is based on the rating of these instruments.

For CDS, in its previous report (Ref. CESR/09-348), CESR was of the view that a post-trade transparency regime should cover all CDS contracts which are eligible for clearing by a central counterparty due to their level of standardisation. The Technical Advice differentiates between single-name, index and sovereign CDS but keeps the same approach. The proposed post-trade transparency regime should be applicable to these instruments regardless whether the trade has been executed on a regulated market, an MTF or by investment firms trading OTC. The calibration for the proposed post-trade transparency regime is based on transaction size.
In relation to derivatives, CESR has made a generic recommendation for a harmonised post-trade transparency regime that has to be further developed.

Question 8(b): Should the requirements apply by trading venue (regulated market, MTF, systematic internaliser) to any financial instruments traded on these venues or only to those financial instruments fulfilling certain qualitative or quantitative criteria as specified under (a) above? If so, should separate requirements apply to OTC trades as well?

Please see the response above.

Question 9: Pre-trade transparency not being considered in CESR's report on Transparency of Corporate Bond, Structured Finance Products and Credit Derivative Markets, please assess whether there is any evidence of a failure in the level of pre-trade transparency available in these markets? Do all potential participants have access to pre-trade information on even grounds, for example in the case of retail investors in relation to non-equity products made available to them?

As indicated in paragraphs 18 and 19 of the Technical Advice, it can be said that the majority of consultation respondents stated that there was no lack of pre-trade transparency. Furthermore, given the fact that most transactions are made OTC and that there is a varying degree of liquidity amongst instruments, most respondents expressed that a mandatory pre-trade transparency regime would be very difficult to implement and would be unlikely to deliver benefits.

Overall wholesale participants generally seemed content with the way in which these markets worked and their access to pre-trade transparency information. However, pre-trade transparency information for small participants, including retail investors, was considered to be less accessible. Nonetheless, these are markets typically dominated by professional investors and retail investment in the financial instruments stated above is residual[21].

Question 10: Considering recommendations from the G20, and the Commission Communication on Ensuring efficient, safe and sound derivatives markets , and notwithstanding CESR's advice regarding energy derivatives, please assess whether similar or other shortcomings in the level of post-trade and/or pre-trade transparency arise for derivatives not covered by CESR's report on Transparency of Corporate Bond, Structured Finance Products and Credit Derivative Markets (interest rate derivatives, FX derivatives, equity derivatives, commodity derivatives).

As appears in paragraphs 22 and 24 of the Technical Advice, in relation to pre-trade transparency of all the instruments analysed (including interest rate derivatives, FX derivatives, equity derivatives

[21] Except for a limited number of Member States, where relevant retail participation is observed, both in terms of number of trades and traded volume.

and commodity derivatives), CESR is of the view that there is currently an unlevel playing field in the EEA with respect to the provision of pre-trade transparency for instruments other than shares. CESR therefore recommends that current voluntary arrangements are put on a formal footing and that a compulsory harmonised pre-trade transparency regime be introduced. The regime should apply to organised trading platforms (RMs and MTFs) with respect to the non-equity instruments traded on these platforms. Similar to the pre-trade transparency regime for equity, this regime needs to be refined to provide appropriate pre-trade transparency standards for various market structures and trading models, taking into account the various instruments and asset classes traded. As for equity, this may also involve the provision of appropriate waivers.

Given the different characteristics of the wide range of products concerned, each with its respective market microstructure and the varying degree of liquidity exhibited in these markets, CESR does not, at this stage, propose to introduce mandatory pre-trade transparency requirements to the OTC space. Nevertheless CESR would welcome that any future regime allows Member States to introduce local requirements if they deem them to be necessary given the specificities of their markets in question.

Regarding post-trade transparency, CESR recognises in paragraphs 125 and 126 of the Technical Advice that the analysis undertaken is still in an early phase, given the heterogeneity of all the OTC derivative segments covered. Nevertheless, CESR is strongly of the view that enhancing post-trade transparency for these assets will assist market participants in making investment decisions as well as supporting more resilient and transparent markets in general. CESR therefore recommends that a harmonised post-trade transparency regime for these assets should be further developed.

Question 11: In view of CESR's work on transaction reporting of OTC derivatives and on trade repositories (TRs), please assess:

Question 11(a): how best to arrange the flow of information to be provided by investment firms to regulators for transaction and position reporting purposes? Please consider the objective of minimizing any double reporting for investment firms:

The Commission consultation paper on Derivatives and Market infrastructures released on 14 June 2010 was used as a starting point for CESR's response. Having analysed the proposal of the Commission on a Regulation on OTC derivatives, CCPs and trade repositories (previously known as EMIR), CESR noticed no major change in respect of position and transaction reporting. However, any fundamental changes to the proposal in the course of the negotiation process may affect the premises of this analysis and would require changes to CESR answers and advice. The content of this answer should, therefore, be read with this caveat.

Differences between transaction and position reporting

Transaction reporting obligations provide for reporting of individual transactions on specific financial instruments. Position reporting, on the other hand, aims at providing information on the economic exposure of an investor or counterparty to a specific derivative instrument, an underlying instrument, an underlying issuer of financial instruments and/or a counterparty at a specific moment of time (date).

There are several differences between transactions in OTC derivatives and the resulting positions that may merit different solutions for the purpose of reporting to regulators.

Transaction reporting is a "flow variable", while position reporting is a "stock variable". Reporting transactions to regulators for the purpose of market abuse detection has to be a daily flow of information and delays must be avoided at all costs.

Transaction reporting for market abuse surveillance purposes has been identified as a need by regulators well before the financial markets crisis started. Transactions in OTC derivatives are already reported in some EU Member States (at least UK, Spain and Ireland), where this information plays a fundamental role in market monitoring. Many other Member States have plans to introduce transaction reporting on OTC derivatives in the short term (coming months) under recital 45 of MiFID. However, the development of a regulatory position reporting to monitor systemic risk and improve prudential supervision has been a clear consequence of the crisis. The calendar for the adoption of such a regime will be subject to the adoption and implementation of EMIR. Furthermore, there is also a non-legislative initiative that is sponsoring the creation of TRs in the context of the commitments of some ISDA dealers. This project is clearly aligned with the purpose of EMIR and highly valuable at the moment, but its current progress and scope is not as developed as MiFID transaction reporting for market abuse surveillance purposes.

Transaction reporting has been of interest mainly for securities regulators, namely for supervision of conduct of business rules and, in particular, market abuse. Position reporting, on the contrary, has so far been mainly an objective for prudential/systemic supervision (both insurance and banking supervision), especially to detect concentration of systemic risk and prevent possible complications. Position reporting may become of increased interest for securities regulators (e.g. in the context of the introduction of measures to ban and/or disclose short selling transactions, to monitor open interest positions in one specific underlying instrument or issuer, or to enforce new provisions arising from EMIR), and also transaction reporting of increased interest for prudential regulators; however, the two data flows are likely to remain complementary to one another, with differences and overlaps. In addition, the expected level of detail of the data (granularity) may be different for prudential and securities regulators.

Currently, the information gathered and stored by existing TRs is different from the information necessary for supervision of compliance with MiFID and MAD provisions. Although no details are final yet, it is probable that TRs will host in the future information on foreign underlying instruments that are not admitted to trading on EU regulated markets (i.e. an equity swap position on IBM shares or a CDS transaction on US government bonds), as well as categories of derivatives that are of less interest for securities regulators (interest rate or currency derivatives). Besides this, some information that is essential to calculate positions accurately (e.g. exercises of options) and has to be sent to TRs is of little or no use for market surveillance and does not need to be included in transaction reporting.

In addition, the scope of application of MiFID and EMIR will probably be different. MiFID provisions apply solely to financial intermediaries (investment firms) that are the only ones authorised to arrange transactions on OTC derivatives on a professional basis. EMIR, on the contrary, may end up having a more ample scope, engulfing positions held not only by intermediaries but also by investors (hedge funds, insurance companies), for obvious reasons linked to prudential supervision.

Overarching principles for any reporting mechanism

Any regime for position and transaction reporting of OTC derivatives should be guided by some basic principles:

a. Unconditional and quick access to data should be guaranteed to the regulators wherever the TRs are located;

b. Information received by regulators should be in a specific unified format, to be defined pursuant to the provisions of MiFID/EMIR;

c. Data quality should be paramount, since it impacts the quality and accuracy of supervision;

d. Duplication of reporting obligations for firms or investors should be avoided;

e. Extending transaction reporting to OTC derivatives is urgent (and the work to achieve that is much more advanced than the work on position reporting).

In any case, with respect to the second principle, it is assumed that fields and specifications to report transactions (or positions) in OTC derivatives will be pre-defined, based on the work done so far by CESR and on the basis of the technical standards to be developed by ESMA in cooperation with EBA/EIOPA. Therefore, the data that competent authorities will receive will be harmonised and exactly the same no matter how reporting is to be organised. It is also important to stress the need for maximum convergence between standards and formats for reporting to TRs and those used to report transactions to competent authorities under MiFID. Avoiding differences to the maximum extent possible will mean lower compliance costs and more robust information in both.

In order to meet the above overarching principles, CESR has CESR analysed and consulted on (Ref. CESR/10-809) two possible regimes and has now identified a preferred solution. The first possible regime was to establish a single reporting regime for both transaction and position reporting on OTC derivatives, based on reporting through TRs. In this option, both regulated entities and investors subject to EMIR would report transactions in OTC derivatives to TRs (either directly or through authorised reporting mechanisms (ARMs) or CCPs), which would then, together with other information, report positions periodically to relevant regulators (probably prudential ones) and transactions daily to securities regulators. This system, when enacted, would substitute and abolish the MiFID reporting regime for OTC derivatives (but not for the other types of financial instruments). However, due to numerous disadvantages[22], and on the basis of the responses received in the public consultation, CESR has discarded it.

CESR preferred solution for organisation of position and transaction reports on OTC derivatives

CESR suggests defining a new position reporting regime through TRs and, once TRs are fully established, allowing MiFID firms to fulfil their transaction reporting obligations through reporting via TRs.

This system is based on the assumption that all persons not exempted from EMIR (including MiFID-authorised firms) would have to report transactions on OTC derivatives to TRs after these will have been established, registered (or recognised for those not located in the EU[23]) and their regulatory regime defined.

This proposal, however, contemplates that investment firms would retain the possibility of complying with their transaction reporting obligations with respect to OTC derivatives under MiFID provisions. This implies that transaction reports could be sent directly to the relevant competent authorities, together with all the other transaction reports provided following MiFID requirements.

Investment firms reporting their transactions to a TR, supporting MiFID standards, would be exempted from direct reporting *ab initio* (not case by case) when they communicate to the competent authority their decision to report their OTC derivatives transactions through a TR. Therefore, the MiFID regime would apply to reporting obligations but these could be dealt with by TRs for the account of investment firms in order to avoid duplication.

Concisely, as long as EMIR has not been finalised and implemented, OTC derivatives transactions would be reported under MiFID rules, where applicable. When EMIR comes into force and TRs have been registered and start to operate, these transactions could be reported through TRs to relevant

[22] Two different types of information; Multiplication of the possible reporting channels by each investment firm; Potential risk arising from market power of TRs (that come close to natural monopolies); Different timelines between OTC derivatives transaction reporting and EMIR, etc.

[23] When referring to TRs, no distinction is being made between EU or non-EU repositories as long as they are registered or recognised under the EMIR regime.

competent authorities, but complying with MiFID obligations. In other words, TRs (and ARMs[24] and CCPs) would be recognised as a valid third party reporting mechanism under Article 25(5) of MiFID.

Firms obliged under MiFID to report transactions would be responsible for i) informing their competent authority of the channel they intend to use to report each class of OTC transactions (directly, through a specific TR, through a CCP or otherwise) and ii) establishing the necessary arrangements with any third party to ensure that those transactions will reach the competent authority within predefined time and the required format. TRs (and ARMs and CCPs) will, of course, need to have an updated list of which members are relying on them for fulfilling MiFID transaction reporting obligations to each member's competent authority.

In line with the EMIR proposal, position reporting will be conducted through TRs and, when they will not be able to record the details of the contracts, directly to regulators. CESR will soon start the necessary work for the definition of the technical standards in this respect, in particular for the identification of the relevant fields in both cases.

The advantages of this solution include:

a. Compatibility with existing systems and no risk to impede the immediate extension of the MiFID regime to OTC derivatives. CESR members could continue working on transaction reporting of OTC derivatives irrespective of when EMIR comes into force.

b. Avoiding double reporting obligations.

c. The possibility for investment firms to comply with MiFID provisions to report transactions by relying on TRs (and/or CCPs).

d. Information from TRs could be distributed and shared through TREM, seamlessly (same files, timing and rules, system operated by ESMA) with all other transaction reporting information, allowing easy integration in market surveillance systems.

e. Minimum implementation work or no work at all if the exemption of direct reporting when using the TRs would be enshrined into the MiFID Implementing Regulation.

In all likelihood, if the TRs' system for transaction and position reporting on OTC derivatives proved to be more efficient, most - if not all - of the transaction flow would come in the future through centralised facilities like TRs (or CCPs/ARMs).

An important issue with regards to this model relates to the authority to which reports should be transmitted by TRs acting as reporting channels. Under the current MiFID framework, a third party reporting mechanism has to report to the investment firm's competent authority. When TRs or CCPs are recognised as reporting channels under Article 25 of MiFID they will have to send the transactions of each member that is relying on the TR/CCP for fulfilling its MiFID transaction reporting obligations to that member's competent authority. This will imply establishing connections with different competent authorities. CESR has discussed the possibility of allowing a single reporting point for TRs (for instance, their own competent authority if they are EU-based or ESMA) and a subsequent circulation from that single point to the relevant national competent authorities. However, a consensus on whether that single reporting point should be allowed could not be reached. It should, however, be noted that under EMIR the relevant competent authorities (e.g for banks and insurance companies) will need to receive the position reports directly from TRs and ESMA would need to share with other authorities the information held by TRs that is relevant for the exercise of their duties.

[24] When referring to TRs for reporting purposes in the following sections, reference is also made to CCPs for trades cleared through them and to ARMs.

CESR proposal to extend the scope of transaction reporting obligations

Recital 45 of MiFID provides discretion for Member States to apply transaction reporting obligations enshrined in Article 25(3) to financial instruments that are not admitted to trading on a regulated market. There are two clear extensions that some Member States have adopted or are considering on the basis of the experience after MiFID came into effect: 1) extending reporting obligations to transactions in financial instruments admitted to trading only on MTFs (but not on regulated markets) and 2) extending reporting obligations to transactions on certain OTC derivatives.

Extension to the instruments admitted to trading only on MTFs

There are several reasons for engulfing financial instruments admitted to trading only on MTFs within the transaction reporting obligations. According to Recital 6 of MiFID, definitions of regulated markets and MTFs should be introduced and closely aligned with each other to reflect the fact that they represent the same organised trading functionality.

Regarding the Market Abuse Directive (MAD), the European Commission has recently consulted[25] on extending the scope of MAD to cover instruments which are admitted to trading and/or traded on an MTF but not on a regulated market. Since the MiFID transaction reporting regime is one of the main supervisory tools for market abuse purposes, it is therefore essential for this regime to cover all transactions that could potentially constitute market abuse, including the ones on instruments admitted to trading only on MTFs.

Transparency mechanisms, financial product innovations and the general impact of events in globalised markets and platforms all call for the need of competent authorities to have regular information about the trades on financial instruments admitted to trading only on MTFs. If MTFs develop (some are doing so already now) their role as alternative markets for different types of issuers (mid and small caps, for instance), this would also be a good reason to introduce transaction reporting requirements for transactions made in financial instruments admitted to trading only on these trading venues.

Therefore, a common effort has to be done in order to ensure the capability of competent authorities to have information on instruments admitted to trading only on MTFs and to have the appropriate tools to correctly apply policies to prevent market abuse. CESR considers that this should be done through MiFID, and not by extending nationally the obligations on the basis of recital 45 of MiFID.

Extension to some OTC derivatives

On the matter of OTC derivatives, in order to enhance competent authorities' ability to detect suspicious activity and maintain the integrity of their markets, CESR members have decided to exchange transaction reports on some OTC derivatives. CESR is currently working on harmonising the technical standards on the collection and exchange of transaction reports to include OTC derivatives whose value is derived from instruments admitted to trading on a regulated market or an MTF. The relevant consultation paper (Ref. CESR/09-768) and feedback statement to it (Ref. CESR/09-987) can be found on CESR website.

Recent events in financial markets have shown the clear need of having information about trades on OTC derivatives, both for market surveillance and investor protection purposes.

Financial derivative products typically traded OTC, like CDS, OTC options or total return swaps, have proved to play a very important role in recent market situations where strong volatility movements have finally affected all sectors, countries and types of investments.

[25] http://ec.europa.eu/internal_market/consultations/2010/mad_en.htm

Moreover, competent authorities have noted that, due to financial product innovations, there is a range of OTC financial instruments that mirror instruments admitted to trading on regulated markets or MTFs that can affect prices on regulated markets and MTFs and that can equally be used for the purpose of market abuse, which are now out of the scope of the transaction reporting exchange mechanism.

As long as OTC financial instruments can mirror products admitted to trading on regulated markets or MTFs, the price and volatility relationship between them is direct and unavoidable, and has to be considered when conducting market abuse investigations. Some OTC derivatives have reached such a high degree of popularity and trading activity that they can perfectly influence (not only follow) the price evolution of the traded underlying they are related to.

Transaction reporting of OTC derivatives would meet the requirements expressed by G20[26] to improve the regulation, functioning and transparency of financial and commodity markets to address excessive price volatility.

It is also true that the increasing importance and size of OTC markets makes fully understandable that the competent authorities need to have information about the trades in OTC derivatives. According to recent BIS statistics[27], total notional amounts outstanding of OTC derivatives reached $615 trillion by the end of December 2009, which means a 12% increase compared to December 2008 data.

Competent authorities need to enhance their ability to detect suspicious activities and to maintain the integrity of their markets, and those objectives can only be achieved by collecting and exchanging specific information about trades executed on both regulated markets, MTFs and OTC.

Some regulators are already collecting information about trades on OTC derivatives whose underlyings are instruments admitted to trading on regulated markets. According to the feedback received from those regulators, this has been a very useful tool to improve their market surveillance activities and to monitor possible market abuse situations.

Since the main reason for the extension of the reporting obligations is the possibility to use an OTC derivative as a substitute to a "traditional" security, the basic criteria to define the scope of the extension would be whether the value of the OTC derivative depends on the performance of a financial instrument that is admitted to trading on a regulated market (or an MTF) or on the credit risk of a single issuer of such financial instruments. Therefore, credit derivatives on baskets or indexes, with no exposure to an individual issuer in particular, would be excluded from the reporting regime.

CESR proposes that the European Commission extends, through a change in Article 25 of MiFID, the scope of transaction reporting obligations to financial instruments that are admitted to trading only on MTFs and to OTC derivatives whose value depends on the performance of a financial instrument that is admitted to trading on a regulated market (or an MTF) or on the credit risk of a single issuer of such financial instruments. In the OTC derivatives case, CESR strongly recommends that the exact scope of the instruments would not be exhaustively set out in the Level 1 text but could be further specified through binding technical standards to be developed by ESMA[28]. This seems essential in order to ensure that the scope of the reporting obligation can be more easily adjusted to respond to the innovations in the market without the need to revisit the Directive every

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[26] http://www.g20.org/Documents/pittsburgh_progress_report_250909.pdf

[27] Source: *OTC derivatives market activity in the second half of 2009, Monetary and Economic Department, May 2010, www.bis.org*

[28] The OTC derivatives initially subject to the reporting obligations would include those covered in section D of CESR's feedback statement on the consultation on "Classification and identification of OTC derivative instruments for the purpose of the exchange of transaction reports among CESR Members" (CESR/09-987).

time a new, significant instrument emerges in the EU market or an existing, non-covered instrument acquires a significant supervisory relevance.

Recital 45 of MiFID could be retained in order to have the ability to require data at national level on other financial instruments that may become widespread in the future and that would need to be included in the transaction reporting regime, but not on an EU wide basis.

Question 11(b): Apart from detecting and pursuing cases of market abuse, what other purposes does transaction reporting have? What purposes does position reporting have?

Information derived from the transaction reports can also be used for the purposes of:

a. monitoring the compliance with the disclosure requirements of persons' discharging managerial responsibilities and shareholders' disclosure rules requirements;

b. determining the minimum price in take-over bids;

c. assessing the order execution policy;

d. ensuring firms are not undertaking transactions in financial instruments they do not have permission to trade; and

e. monitoring compliance with general MiFID provisions.

Information derived from the position reporting can, inter alia, serve the purposes of:

a. evaluating the counterparty risks and assessing the risk profile of investment firms;

b. calculating positions for standardised OTC derivatives and detecting possible risks for market integrity and stability;

c. identifying the relevant contracts for the purpose of the clearing obligation;

d. identifying the systemically relevant counterparties;

e. enforcing the clearing obligation

f. gathering intelligence on the new market trends;

g. providing transparency to the market; and

h. conducting economic analysis.

Question 11(c): What are the experiences of CESR with transaction reporting by regulated markets, MTFs or trade-matching or reporting systems by pursuant to article 25(5) MiFID?

Different reporting options were chosen by Member States when implementing MiFID transaction reporting provisions. Though it would be difficult to identify a particular preferred reporting channel, CESR members expressed general satisfaction with the local choices (whether reporting through the regulated market, MTF, reporting system or firms themselves) and did not have any major concerns.

Question 12: In light of the G20 endorsement of the IOSCO recommendations regarding commodity derivative markets, the increased participation of financial participants as an alleged possible factor influencing the price of physical commodity markets via the respective derivative markets, and the recent volatility in these markets:

Question 12(a): Please provide us with an overview of existing position reporting arrangements in the different Member States. Do these arrangements arise from national legislation or are these initiatives undertaken together with derivative exchanges?

Position reporting arrangements in different Member States

Specific arrangements on commodity derivatives position reporting currently exist in three Member States.

In the first case, the positions on commodity derivatives are reported directly to the competent authority (CA) by the clearing house of the regulated market where the transactions took place (transactions are reported directly by the market operator of the commodity derivatives regulated market). The positions reported are those of the members of the clearing house and are segregated according to three types of account i.e. for own account, for client accounts and "market maker".

In accordance with its rules, the clearing house monitors the open interest of its members and can take action in case position limits (specific to each derivative contract) are exceeded. This provides thus a first level of supervision of systemic risk (and delivery risk for commodities) even though limited to the clearing house members' level.

It should be pointed out though, in the current situation, this CA does not receive information about the positions of the final beneficial owners of the traded contracts or about any positions held on the spot markets. Neither are OTC transactions on commodity derivatives or aggregated positions taking these transactions into account available.

In this case, the existing arrangements are the result of historical arrangements.

In the second case, positions in relation to commodity derivatives are disclosed to the CA in monthly reports submitted by investment firms monthly. The information is being provided in accordance with the domestic law.

In the third case, the commodity derivative exchanges provide regular position reports to the CA on either daily or weekly basis. Primary responsibility for monitoring and reviewing positions lies with the regulated markets but the CA undertakes a secondary review of the information and engages with the regulated markets as appropriate. There are no specific legislative provisions for submission of this particular information, however, general provisions on co-operation/provision of information can be applied.

Position reporting arrangements in the US[29]

In the US, the CFTC collects – in accordance with the respective CFTC Regulations – market data and position information from exchanges, clearing members, future commission merchants (FCMs) and traders. Exchanges must provide the CFTC with confidential information on the aggregate positions and trading activity for each of their clearing members, in addition to providing public data on trading volume, open contracts, futures delivery notices, exchanges of futures for cash, and prices. Each day, exchanges report each clearing member's open long and short positions, purchases and sales, exchanges of futures for cash, and futures delivery notices for the previous trading day. This data is reported separately by proprietary and customer accounts by futures month, and for options by puts and calls, expiration date and strike price.

[29] http://www.cftc.gov/IndustryOversight/MarketSurveillance/LargeTraderReportingProgram/index.htm

The CFTC uses data like this to identify large cleared positions in single markets or across many markets and exchanges, to audit large trader reports, and to resolve any account aggregation issue.

Clearing member data, however, do not directly identify the beneficial owners of positions. The aggregate customer position reported for a clearing member could represent either a single trader or numerous traders. The data does also not reveal a circumstance where a single trader controls substantial portions of the customer positions with more than one clearing member, and therefore, could control a substantial portion of the market. To assess individual trader's activities and potential market power, the CFTC has established a large trader reporting system (LTRS). This is also used to enforce position limits.

Under the CFTC's large trader reporting system, clearing members, FCMs, and foreign brokers (i.e. 'reporting firms') file daily reports with the CFTC. The reports show futures and option positions of traders with positions at or above specific reporting levels as set by the CFTC. If, at the daily market close, a reporting firm has a trader with a position at or above the CFTC's reporting level in any single futures or option expiration month, the firm reports that trader's entire position in all futures and options expiration months in that commodity, regardless of size.

Since traders frequently carry futures positions through more than one broker and control or have a financial interest in more than one account, the CFTC routinely collects information that enables it to aggregate related accounts. This enables the CFTC to make an assessment of a trader's potential market impact and a trader's compliance with position limits.

Aggregate data (without identifying any individual reportable trader) concerning reported positions are published by the CFTC in its weekly Commitments of Traders reports. The CFTC may also issue a special call to a reporting firm or a trader to investigate a threat of a market manipulation or other market disorder. The special call is designed to gain additional information about a firm's traders and/or about a participant's trading and delivery activity, including information on persons who control or have a financial interest in the account. The special call may also request information about positions and transactions in the underlying commodity.

Question 12(b): In your view what are the benefits in terms of regulatory oversight (*of positions*)?

There is widespread support for a system of position reporting to regulators. Position reporting is of value in preventing, detecting and enforcing against market abuse. In commodity derivative markets the investigations undertaken to date indicate that abusive behaviour often comes about as a result of attempted market squeezes, e.g. where a participant attempts to corner a market by building up a dominant position which distorts the price formation and prejudices other participants ability to trade out of their own positions. To the market supervisor, having information which shows how the suspected abuser's position has changed over the preceding period will be highly informative in seeking to understand the behaviour.

Position information can also be of use in seeking to protect market integrity and stability. For example, at times of high market volatility, being able to look at positions in the market and identify whether any particular trader or group/type of trader's behaviour can be attributed as being influential in bringing about that market behaviour will be of use because of the value of being able to see how positions have changed over time.

It is important to have both transaction and position reports since, in an investigation, the investigator will always look at the relevant individual trades of the associated parties at the time of the suspected abusive behaviour. Given the complex nature of these markets, transaction records alone are unlikely to explain the trading patterns.

The other potential use of position information from commodity derivative markets is for prudential regulation. Position information is of use to the firm supervisor in assessing a firm's exposures and its compliance with capital adequacy requirements.

Position information is of use when looking systemically at the exposures of a group of firms of a particular type, or of some or all of the firms within a particular market. Aggregating the information on the positions of the individual firms will show the total exposure of the group and this can be used to assess whether that presents an unacceptable risk, either to that sector of firms, or to the market in which the positions are held.

To get a true picture of the nature of a position held by a participant the supervisors/investigators need ideally to be able to see the participants' exchange, OTC and physical market positions. For example, a participant may appear to have an unnaturally large position on an exchange in a particular commodity. If this however can be seen as a natural hedge for an offsetting OTC or physical position then it may demonstrate that the large or dominant position is in fact acceptable and not abusive.

Similarly, for capital adequacy/prudential assessment, systemic reporting of a firm's positions on all markets will be of value. For instance, should a supervisor give more attention to a firm which it sees has fifty per cent of the total exposures in one particular market, or to another firm which has a thirty per cent exposure in five related markets? Having wide-ranging reports on firms' positions would be beneficial in deciding how to prioritise supervisory effort.

An additional possible benefit of requiring commodity derivative position reporting to regulators would be that it would likely introduce highly useful standardisation of the content and format of position reports which current reporting through market operators, all of whom have their own systems, does not provide. Standardisation of position reporting may also be fostered by potential future requirements for trade repositories to provide information to regulators.

Regulators receiving position reports themselves would have an ability to make potentially more exacting checks on how market operators are fulfilling their domestic obligation to collect and act on position information from their participant firms in the interests of ensuring their facilities are not used for abusive activity[30].

The downsides for regulators to receiving position information appear limited. There is a challenge for regulators in receiving significant amounts of additional information, which they will need to be appropriately resourced to review. The mere collection of information is useless if the information cannot be properly processed and effectively used. Another drawback is the likely cost of implementation and review, both for firms and for regulators.

Creating a dual system where regulators are effectively obliged to duplicate the exchange's monitoring role at some level, because of the information they receive, may frustrate the initial objectives of the framework MiFID has created. In many Member States market operators were made front line regulators. It could therefore be argued that this kind of supervisory system intended that the pool of specialised market monitoring and supervising resource was designed to coalesce at market operator level. Creating similar obligations for regulators may create risk from lack of clarity over split responsibilities.

When creating a system of position reports to regulators, the use of existing sources of position information of exchanges (RMs, MTFs and other spot exchanges), central counterparties and trade repositories should be explored to avoid frustration of firms by requirements to report to multiple entities/regulators, In evaluating technical possibilities it also needs to be taken into account that some of these entities may be located outside the EEA.

30 For more information on the position management approach currently applied in some Member States see also the answer to question 12(d) below.

Question 12(c): Would data by type of trade (e.g. commercials, investment firms, fund managers, etc) be of further use? How?

It would be useful for a number of purposes to have this type of information.

The information would be useful for understanding the risk profile and business models of regulated financial firms, which could provide valuable information on their overall exposure and systemic risks posed relative to other market users.

Information of this type would also be of value because it could be used to provide additional transparency to the markets. This could come about if the data were used, as has been recommended by IOSCO's Commodity Markets Task Force, to underpin the publication of aggregated open interest reports similar to the CFTC's Commitment of Trader reports, which have been published for US markets for many years. These reports provide information on how the break-down of open interest between participant type changes over time[31]. Many stakeholders, including analysts in particular, value this type of information for attempting to explain price movements and other market behaviours to constituents who, unlike regulators, do not have the complete underlying information set.

When considering Commitment of Trader style reporting, the classification of participants requires careful examination however. There are certain participants which are not easy to categorise, and by the same token others which may fall into more than one group because they trade for more than one purpose. Clearly the primary objective is to get the most meaningful classifications. The reports will have most value if they can present an international picture for markets which are international, i.e. wider than a single continent.

The downsides to receiving and publishing information of this type are few. Again, one of the most obvious downsides to consider is clearly that this would represent an additional cost to the market and to regulators..

Question 12(d): What regulatory purposes could a system of position limits best serve?

Purpose of position limits

Position limits are used to serve different purposes in commodities markets.

Anti-manipulation

Position limits have been used by certain exchanges, primarily in the United States, as a tool for preventing abusive squeezes in a commodity derivatives market as it approaches physical delivery. Limits are applied most typically to positions in the final three pre-expiry days of the contract to prevent any participant or any group of participants building up a dominant position from which to effect a market squeeze, typically manifested as an undesirable price movement. They may be viewed as primarily effective for physically settled contracts where supply of the underlying deliverable is finite.

Preventing large concentrations and or "excessive speculation"

The CFTC has recently consulted[32] on a new system of position limits for energy market derivative contracts which would apply throughout the lifetime of a derivatives contract. The Proposed Rule

[31] See also the description in the answer to question 12(a) above.

[32] On 18 August 2010, the CFTC has withdrawn its proposals on 'Federal Speculative Position Limits for Referenced Energy Contracts and associate Regulations' as it plans to issue a notice of rulemaking proposing position limits for regulated exempted commodities contracts, including energy commodity contracts, as directed by the recently enacted Dodd-Frank-Act.

would allow the CFTC to directly impose position limits for futures and option contracts in energy commodities, in particular limits for futures and option contracts in four energy commodities traded on NYMEX and ICE. The proposed position limits are intended to reduce the market concentration of large market participants to ensure they do not disrupt the price discovery or liquidity of the markets. They may also be interpreted as being aimed to prevent any market participant or class of participants from building up positions during the contract which would represent an over-concentration. Commentators have opined that the rationale for these proposals is to establish a regime to combat the believed effect of passive long-only market participants, which may build up significant positions which, whilst not manipulative of themselves, cause an undesirable price movement. These positions are typically considered as speculative and as such, limits on them may be used to counter "excessive speculation".

Whilst "excessive speculation" is an undefined term, its origins are linked to price movements in onion derivatives which led to its incorporation in US legislation and to its combat being included in the CFTC's objectives. Indeed these events, which date back to the 1930s, led to the introduction of position limits for physically delivered contracts[33]. The current CFTC consultation has followed a period of significant volatility and extreme price movements in energy derivatives markets, most notably oil.

It is important to note that in both of the above position limits applications, a system of exemptions to allow legitimate hedging of physical positions, is applied. The Proposed Rule suggests to establish a uniform process for the CFTC to grant swap dealers limited risk management exemptions for swap transactions instead of the bona fide hedging transaction exemption that they currently obtain through the exchanges.

Current EU position

European legislation has to date charged European exchanges and regulators with, amongst others, the objective to combat market abuse. There has not to date been any European legislation in this area which obliges European financial services regulators and or market operators to combat excessive speculation.

Certain European exchanges employ position limits in the traditional manner as anti manipulation tools, although this is not mandated in European legislation. Market operators are however charged with an obligation for ongoing monitoring of their markets to prevent, detect and – in some jurisdictions – enforce against market manipulation. This obligation applies to the entirety of the contract's life. Market operators commonly monitor positions on a real time or daily basis and take action over any position of concern. This action can include consultation with the participant and/or with regulatory authorities. Market operators can often also use their powers to either force the participant to reduce the position or to reduce it unilaterally if the participant is unable or unwilling to do so. In many jurisdictions, regulatory authorities can order the exchange to take action if they consider this necessary. This approach may be termed "position management". However, there are no harmonised requirements in EEA legislation regulating this kind of position management.

The case for position limits

The potential benefits and drawbacks set out below apply in the context of employing position limits to prevent market manipulation and to ensure orderly markets.

Benefits of employing position limits

Potential benefits of position limits may include:

[33] Note that position limits were never intended to apply to cash settled contracts, of which there are many in EEA markets.

- Position limits can be employed as a part of a set of tools to combat abusive/manipulative strategies.
- In contrast to a position management approach, position limits are more transparent and could give market participants a level of certainty. Once set, compliance becomes objective (setting aside the potential impact of decisions on exemptions).
- Formal exemptions may be granted, giving the market monitor/regulator clarity over how an exempted participant may behave in the market.
- Position limits may be to limit the exposure of a certain type of participant to prevent it/the group taking on an unacceptable exposure, i.e. one which it cannot sustain.
- Given the certainty of published, hard limits, they may improve the public's confidence in the functioning of markets which determine the price of many key consumables.
- A system of position limits for Europe could mirror arrangements for US markets, aligning regulatory approaches in what are in many cases global markets.

Drawbacks of employing position limits

Potential drawbacks of position limits may include:

- A published limit is inflexible and can only be reviewed after due process has been followed. This may result in an inappropriate limit for prevailing market circumstances (since each contract month can be different).
- The limit may be seen as subjective or arbitrary and as such may damage market confidence.
- Limits typically apply to all or all of a certain class of market participant. This may be inappropriate since different position sizes may be acceptable for different participants. "One size does not fit all".
- They may be used as a 'decoy' by participants which hold positions that are not suitable for the particular participant or market, but which do not breach the limit. For example, a fund which has no capacity to take delivery sitting on a position which is just below the position limit but may result in a failed delivery if not reduced prior to expiry.
- Limits may provide 'false comfort' since there are likely to be market attempts to circumvent them, e.g. underlying investment interest may be divided amongst numerous market participants to mask what would otherwise be a limit-breaching position.
- If limits are too tight, they may impact liquidity and/or volatility, thereby damaging market confidence.
- A system of position limits inevitably requires that exemptions are granted. These may not be understood by alternative market participants and create uncertainty or damage market confidence.
- The granting of exemptions is subjective. Certain participants have hedging and speculative elements to their trading book and yet to date exemptions have covered the whole of the book.

CESR position regarding a regulatory regime for position limits

The key objectives for financial regulators should remain the maintenance of orderly markets and combating market manipulation.

Accordingly, regulators should have a complete set of tools to ensure markets are orderly and that manipulation is deterred. On the basis of the discussion in the Stakeholders' Workshop[34], CESR considers that stakeholders share this objective. It recommends therefore that the key issue the

[34] For details see Annex II below.

Commission should focus on analysing whether exchanges/regulators sufficiently extensive set of powers to manage positions across the entire life of commodity derivatives market contract curves setting up a harmonised set of powers for exchanges/regulators in European legislation and considering whether there is a need for further harmonisation in the way those powers are actually implemented across EU commodity derivatives markets. When pursuing a position management approach, greater clarity should be given about position management by publishing guidance on what measures are typically taken into account when making decisions on how positions are managed.

Position limits may appropriately sit within that set of tools but they do not appear to be the answer to ensuring orderly markets and an effective safeguard against manipulation in their own right. A wider review of regulators' powers to maintain orderly markets and combat manipulation would be more appropriate.

It is key that MiFID and MAD regimes give all regulators a set of comprehensive information to detect manipulation and appropriate powers to combat it. In accordance with the IOSCO recommendations, regulators (and exchanges where appropriate) need clear and unambiguous authorities which give them access to a full set of information on positions held across exchange and OTC markets as well as powers to access information on physical positions where this is required[35].

There is little evidence so far to suggest that markets where position limits have operated for the life of the derivative contract have been any less volatile than those which have not. Nor is there sufficient evidence so far that position limits can systematically be used to limit the impact that significant positions may have on the prices markets generate. Accordingly, it remains to be further assessed whether or not position limits are suited to achieving the objectives of reducing volatility or limiting the impact that large positions may have on market prices and the Commission may reconsider this based on further market development.

Question 13: Against this backdrop, and its earlier advice concerning Article 2(1)(i) and (k) of MiFID notwithstanding, please assess whether market oversight could be impaired if exempted firms do not fall under the scope of possible future reporting requirements to trade repositories and/or regulators?

Exclusion of any class of market participant from reporting obligations at first glance impairs regulators having a set of information which gives them a "whole market" view, which is valuable for market surveillance and enforcement. However, it is important to assess the significance of the gap in the picture given to regulators and whether this can be mitigated from other sources.

Records of positions and trading of a firm are important to the market monitor or regulator and these will always be consulted when examining a particular course of conduct[36]. However, if the information is available to regulators otherwise than through the direct reporting they receive then the risk arising from the apparently incomplete view may be mitigated. For commodity derivatives traded on exchange, transaction reporting is already operational through market operators reporting to their regulators in various jurisdictions. In their advice of October 2008, CESR/CEBS[37] noted that arrangements where regulated markets provide transaction reports in relation to commodity derivatives to their home Member State competent authorities continue to provide a satisfactory solution.

[35] See also answer to question 12(b) above.

[36] See also CESR/ERGEG advice to the European Commission in the context of the Third energy package (Ref.; CESR/08-998) regarding record keeping of trades in electricity and gas contracts, available http://www.cesr.eu/popup2.php?id=5478. .

[37] CESR/CEBS's technical advice to the European Commission on the review of commodities business (Ref. CESR/08-752), 15 October 2008, available at: http://www.cesr.eu/popup2.php?id=5306.

Further, in the UK, MiFID exempt firms are subject to domestic regulation and accordingly their trading records may be accessed by the UK FSA. These alternative routes to the information provide a significant mitigation of the risk of an incomplete view.

However, it should be noted that a complete unified transaction reporting system direct to regulators would bring benefits of standardisation of the reports and immediacy which the alternative routes referred to cannot provide. It would also align MiFID with MAD for commodities derivatives markets, which would appear to be the logical position.

As outlined under questions 12(b) and (c) above, a position reporting system which provides a whole view of the market would also have many benefits. It needs to be further explored how trading platforms, central counterparties and trade repositories may be involved in this kind of reporting to regulators taking into account that some of these may be located outside the EEA. Considering that EMIR relies on MiFID definitions of investment firms, MiFID exempted firms will be out of the scope of EMIR, unless they are above the identified threshold. The problem, therefore, is that transactions between two exempted firms will not be captured by EMIR provisions, leaving a possible substantial part of the trading activity undetected.. Depending on the actual application of the reporting obligation to non-financial firms, which is related to the level of information threshold, regulators will have a more or less 'full picture' of the OTC market. Some potential gaps could also be mitigated by a system of large trader reports[38].

Drawbacks to extending reporting requirements to MiFID exempt firms clearly include costs to firms and regulators of the additional reporting. Also (and again as noted by CESR/CEBS[39] and as discussed above under question 12(b)) for trading platforms, creating wholesale reporting to regulators potentially undermines the role of exchanges as front line regulators of their own markets.

Question 14: In the context of the CESR work on post-trade transparency in corporate bonds, structured finance products and credit derivative markets, could CESR provide us with any relevant information collected on the level of the de facto existing trade transparency including any description of existing sources of pre- and post-trade information, mostly through electronic systems?

In order to respond to this question, CESR included the following question in the Consultation Paper on the Technical Advice to the European Commission in the Context of the MiFID Review – Non-equity Markets Transparency (Ref.: CESR/10-510)[40].

"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, e) commodity derivatives?"

As a general comment it is important to note that no responses to this question were received from retail investors. The majority of responses received were sent from buy-side and sell-side firms, execution venues and investment banks.

[38] See description of the CFTC's large trader report system under Questions 12(a) above.
[39] See footnote above.
[40] Consultation Paper on the Technical Advice to the European Commission in the Context of the MiFID Review – Non-equity Transparency (Ref.: CESR/10-510), 7 May 2010, p. 5, available at http://www.cesr-eu.org/popup2.php?id=6629.

Pre-trade transparency

Some responses identified sources of pre-trade transparency information without stating the asset classes covered by the source, such as:

- Pools of liquidity or alternative trading systems where pre-trade transparency is available;
- Bespoke in-house software that aggregates market data and indications of interest from liquidity providers and agency brokers; and
- Instruments traded on regulated markets that are subject to pre-trade transparency.

BONDS: Respondents were able to identify a significant number of sources of pre-trade transparency for bonds. These include dealer runs, parsing services, indices providers, price aggregators, electronic services, bids wanted in competition (BWIC) and offers wanted in competition (OWIC). In particular, one respondent noted the pre-trade transparency regime of Borsa Italiana and ExtraMOT for Italian bonds (although this respondent also noted that the Italian bond market was quite a liquid market before pre-trade transparency had been introduced). Some respondents also referred to the Order Book for Retail Bonds (ORB) launched in February 2010 by the London Stock Exchange as an example of where pre-trade transparency for some corporate bonds is available.

STRUCTURED FINANCE PRODUCTS: Sources of pre-trade transparency for these products include Bloomberg screens, dealer runs, internal pricing and valuation groups (where rating reports, prospectuses, independent research related to the security in question are analysed), third party data providers, model providers and BWIC and OWIC.

CDS: Sources of pre-trade transparency for these products include dealer runs (which although not firm quotes as they have to be followed by a request for quote (RFQ), some respondents noted the commercial incentive to stand behind the quotes reported), parsing services, BWIC, OWIC, single dealer screens/electronic services, commercial vendors, end of the day marks for clearing eligible contracts provided by CCPs and pre-trade transparency provided by electronic execution platforms. In particular, one participant underlined that it used as a form of pre-trade transparency an analysis of the average bid-ask spread, the number of investment banks that provide regular pricing and the frequency of quoted pricing as a proxy for liquidity.

INTEREST RATE DERIVATIVES: Sources of pre-trade transparency for these products include live trading platforms such as Bloomberg (on which the possibility of direct client access was highlighted by one respondent) and TradeWeb, proprietary systems/spreadsheets from Bloomberg and Reuters; single-dealer pricing and execution screens. Some responses considered as useful for pre-trade transparency information inter-dealer trades, which are widely reported to the market where trade data is not deemed sensitive and dealer information on client positions provided as part of the service, end-of-day price data and mark to market position revaluations available to clients via CCPs.

EQUITY DERIVATIVES: Sources of pre-trade transparency for these products include the information provided by public screen prices available for listed equity products supplemented by requests for quotes from dealers and voice prices upon request. For equity swaps and other delta 1 products sources of pre-trade transparency include the price of the underlying jointly with the price of the 'financial service' offered by dealers and brokers when offering these products. One respondent noted that for bespoke and structured products there is no pre-trade transparency since these instruments do not exist prior to a request to create the particular derivative. A particular case was noted of the order book operated by EDX London, where market makers offer a transparent pre-trade price for exchange traded instruments. Another response focused on the absolute lack of pre-trade transparency based on the need for secrecy.

FOREX DERIVATIVES: One response included a general remark to explain that even for highly bespoke products, what is readily available is information on key inputs such as spot and forward rates and volatilities. Therefore, that respondent clarified that information currently available was more relevant for (short dated) spot and forward FX market, rather than options or long-dated currency swaps. Another response informed that given the highly bespoke nature of FX options (variable strike prices, barrier levels, maturity dates, and so on) there are not generally any direct price comparisons available, although clients have access to the necessary pricing inputs (spot rates, forward rates, etc.). The pre-trade transparency sources reported were broker screens (such as electronic quotation services and electronic indication services), data available from the exchanges, electronic crossing networks, aggregators acting as a principal, direct contact with banks and market makers and data providers.

COMMODITY DERIVATIVES: Several respondents noted that most OTC derivatives are by definition not transparent, since in practice quotes are obtained from 2 or 3 counterparties. If quotes were obtained from more counterparties, there would be a risk of front-running by some of those counterparties. In these cases, the risk is borne by the counterparty that wins the trade and then has to unwind the risk. The reported sources of pre-trade transparency are inter-dealer brokers, electronic exchanges, electronic broker platforms, voice brokerage systems and Reuters and Bloomberg platforms.

<u>Post-trade transparency</u>

CORPORATE BONDS: Some reported sources of post-trade transparency included information provided by regulated markets (and in particular LSE's ORD system), Xtrakter through its TRAX OTC trade matching, Bloomberg, Bondscape or the ICMA initiative. One participant underlined that there is a lack of reliable data identifying realised transactions and a lack of reporting of this data no matter how unreliable it may be. This respondent therefore proposed to create a "reference price" based on market prices which would be useful for issuers who are considering tapping the market. For covered bonds, one respondent clarified that there is no post-trade transparency and for government bonds, there are only subscription services for all prints on an electronic system.

STRUCTURED FINANCE PRODUCTS: Sources of post-trade transparency for these products include Xtrakter (through its service Xbis), e-trading platforms, index providers and post-trade valuations.

CDS: The main sources reported were DTCC Trade Information Warehouse (TIW) and valuations provided by dealers to clients as part of their client service. Some respondents believed that also CCPs will provide post-trade transparency once OTC clearing via CCPs is implemented. One response differentiated between post-trade transparency for end-of-day prices (for which the sources were CMA, Markit, Creditex) and size disclosure (for which the main sources were DTCC or RFQHub).

INTEREST RATE DERIVATIVES: Respondents receive post-trade information from regulated markets, Markit Wire, OTC trade repositories, the information provided about inter-dealer trades which are widely reported to other market makers (unless they may affect liquidity). Regarding future developments, it was considered that CCPs should provide access to end-of-day prices and daily mark to market revaluations. One respondent noted a virtual lack of post-trade transparency apart from discussions in the market place, but also indicated that most trades were too bespoke to be of any comparable value.

EQUITY DERIVATIVES: Two respondents considered that there is no post-trade transparency on OTC trading in this asset class. Two other responses named as sources of post-trade transparency information discussions with dealers, brokers and clients and data from equity derivatives traded on regulated markets.

FOREX DERIVATIVES: broker screens, market data providers and exchanges were reported as sources of post-trade information to the FX market. FX dealers have embraced post-trade transparency through increased reporting via CLS since 2002, covering up to 70% of the daily transaction volume in the FX market. Some participants use bespoke in-house software in order to aggregate market data and Indications of Interest from liquidity providers and agency brokers.

COMMODITY DERIVATIVES: Respondents noted using sources such as clearing house data (including CMV Clearport or ICEClear), information from electronic confirmation and matching platforms or the monthly “special call” report to CFTC. Some responses focused on the lack of post-trade transparency in the OTC space.

Question 19: "Professional clients per se" (Annex II.I of MiFID) and eligible counterparties (Article 24 MiFID) include a number of entities presenting differences in their nature, their size and the complexity of their business (for instance, small and big financial entities providing different types of activities; different categories of "institutional investors", municipalities and other public bodies). In the perspective of further calibrating the treatment of clients:

Q19(a): Please share your supervisory experience and data related to problems encountered in the provision of investment services to professional clients or eligible counterparties. This includes any alleged miss-selling which may have involved public local authorities (e.g. municipalities), small and medium undertakings, institutional investors (e.g. pension funds), or small credit institutions. We ask CESR to provide details about the kind of entities and products concerned;

Q19(b) Please consider possible technical criteria to further distinguish within the current broad categories of clients ("other authorised or regulated financial institutions", "locals", "other institutional investors" (Annex II.I(1)(c), (h), (i) of MiFID), public bodies managing public debt (see Article 24(2) and Annex II.I(3) of MiFID).

See CESR’s Technical Advice to the European Commission in the context of the MiFID Review: Client Categorisation (CESR/10-1040).

ANNEX I: Discussion at the Stakeholders' Workshop

Discussion at the Stakeholders' Workshop

A wide range of views and points were raised by stakeholders at the workshop including those set out below.

Comments on operation of position limits

- Whilst position limits have worked for managing final delivery risk for physically delivered contracts, stakeholders would prefer the flexibility of the position management approach with 'accountability' of market participants and ad hoc requests about their OTC positions to continue since this has worked better than limits.

- The availability of exemptions is essential for legitimate hedging business. However, it is difficult to judge when legitimate hedging becomes speculative. Exemptions introduce subjectivity. Authority for granting exemptions should remain with exchanges which have the experience to decide what is appropriate. Concerns about the subjectivity of position management could be addressed by regulators/exchanges publishing guidance on the factors taken into account.

Position limits to combat volatility reduce "speculation"

- Position limits over the lifetime of the contract curve would be likely to restrict markets, damage liquidity and in turn lead to higher volatility.

- Markets rely on a full range of participants to function. For every hedger, a corresponding "risk buyer" is required. Financial and investor participants play a vital role in this respect, as well as their traditional role as liquidity providers.

- There is little evidence which suggests that markets where position limits have operated for the life of the contract (e.g. US agricultural markets) have been less volatile than markets where position limits have not operated. As a tool, it is questionable whether they achieve the aim.

- Care is needed when assessing "large positions". For example, an apparently large financial position may simply be off-setting an underlying physical position of a participant which in reality has a flat book. It becomes more and more difficult to determine which market player is a 'speculator' since traditional categories of market participants (e.g. producer, financial) are blurring.

- Position limits are likely to result in positions becoming split across risk aggregators, i.e. to lead to a market with a greater number of small participants which are likely to be less well capitalised than larger aggregators and to increase systemic risk.

Combating manipulation

- Stakeholders agreed that combating manipulation is an essential part in maintaining market confidence and agree that regulators should have a complete set of information covering exchange and OTC markets and appropriate powers to deal with manipulative practices.