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FEEDBACK STATEMENT

**Transaction Reporting on OTC
Derivatives and Extension of
the Scope of Transaction
Reporting Obligations**



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Executive Summary

This Feedback Statement (FS) summarises the responses that CESR received to its Consultation Paper (CP) on Transaction reporting on OTC derivatives and extension of the scope of transaction reporting obligations (Ref. CESR/10-809) and sets out CESR's feedback on those responses. It should be read in conjunction with CESR's Responses to questions 1-14 and 19 of the European Commission for additional information in relation to the review of MiFID (Ref. CESR/10-1254).

In general, the majority of respondents supported CESR's preferred option where transactions on OTC derivatives would be reported to trade repositories (TRs) after these will have been established, registered (or recognised for those not located in the EU) and their regulatory regime defined. The preferred option also foresees that investment firms retain the possibility of complying with their transaction reporting obligations with respect to OTC derivatives under MiFID provisions.

CESR also received positive feedback regarding its proposal to extend, through changes 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.



Background

1. In the course of 2010 the European Commission (EC) launched its work on the review of the Markets in Financial Instruments Directive (MiFID). In order to provide the EC with its advice on the issues under review, CESR conducted a series of consultations on the various topics covered by the MiFID review. In the area of transaction reporting, CESR published a CP in April 2010 on its draft technical advice to the EC in the context of the MiFID review in relation to transaction reporting (Ref. CESR/10-299). The technical advice prepared on the basis of this consultation was delivered to the EC at the end of July 2010 (Ref. CESR/10-808). The FS on that CP (Ref. CESR/10-796) was published together with the technical advice.
2. In March 2010 CESR received the EC's request for additional information regarding the review of MiFID¹. The request included some specific questions on transaction and position reporting, which were addressed in CESR's CP on Transaction reporting on OTC derivatives and extension of transaction reporting obligations (Ref. CESR/10-809).
3. This FS summarises, on a question by question basis, the responses that CESR received to the latter CP and provides CESR's feedback on them.

¹ <http://cesr.eu/popup2.php?id=6574>



SUMMARY OF RESPONSES AND CESR'S FEEDBACK

1. Possible ways to organise transaction and position reporting on OTC derivatives

Question 1: Do you agree with the solution proposed by CESR for the organisation of transaction and position reporting on OTC derivatives?

4. The vast majority of respondents expressed a preference for CESR's preferred Option 2. Many specifically emphasised the need to avoid any reporting duplications and to ensure the standardisation of reporting requirements.
5. Several of the respondents, who explicitly welcomed CESR's basic concept of using TRs for the production of transaction reports, however strongly rejected the specific arrangements favored by CESR in the Option 2. They argued that, if – pending the adoption of EMIR and the introduction of TRs – the reporting entities were initially forced to have recourse to the existing reporting systems, the proposed scheme would not be a genuine option. A temporary obligation to report via the existing systems would de facto exclude having the choice between the two Options. CESR's project would firstly make the use of TRs substantially less attractive and, second, impose considerable additional and unnecessary expenditures on market participants opting for reporting through TR. It was considered to be impossible to realise synergies, not even in the case of data quality and data consistency, if the solution to temporarily use the existing reporting systems for OTC derivatives transactions (until the adoption of EMIR or the introduction of TRs) was implemented.
6. Several considered CESR's proposal to be an interim solution. As the frequency of TRs' reporting cycles increases over time, in the interests of avoiding potential duplication and managing IT expenditures, the TRs should take an increasingly central position at the heart of reporting processes generally for non-cleared trades.
7. Although not extensively elaborated in the CP, some respondents explicitly supported the proposal to use central counterparties (CCPs) as a reporting channel. However, it was noted that clarification is needed whether the possibility of using CCPs as a reporting channel for firms is intended to meet transaction reporting requirements under MiFID (i.e. by sending data to competent authorities), but would still require firms to submit reports to TRs. Regulators were urged to consider CCPs as Approved Reporting Mechanisms (ARMs) to submit data to TRs so that there would be a number of ways for firms to meet their reporting requirements efficiently.
8. Several respondents underlined also that CCPs already offer the service of trade repositories for the transactions that they clear and there should be no exclusivity of TRs in providing transaction reports and assisting firms to comply with reporting obligations. Echoing this remark, another respondent pointed out that reporting of transactions to trade repositories is only necessary in relation to business which is not cleared by a CCP. In relation to business which is CCP-cleared, CCPs already store and maintain the relevant data in relation not only to transactions but also, crucially, in relation to outstanding positions.
9. It should be noted, however, that some respondents expressed strong opposition to Option 2 stating that it would not meet the overarching principles of data quality and could be a source of inconsistencies for those entities that duplicate reporting in case that the position reporting in TRs does not match with the transaction reporting they provide by other means. Some of these respondents favored Option 1, which they considered to be the best way to achieve a single regime with no risk of duplication and divergence among Member States.
10. Finally, a limited number of respondents believed that it is premature to consider a reconciliation of the transaction reporting regime with the position reporting via trade repositories, as arrangements and details of the latter are currently not clearly defined.

CESR is pleased to see the support for its preferred option. In its response to the EC request for additional information in relation to MiFID review (Ref. CESR/10-1254) CESR suggested defining a new position reporting regime through TRs and, once TRs are fully established, transaction reports on OTC derivatives could be reported through these TRs, complying with MiFID obligations. In other



words, TRs would be recognised as a valid third party reporting mechanism under Article 25(5) of MiFID.

CESR believes that the preferred option is a practical way forward and would disagree with a statement that it is not a genuine option because of the temporary obligation to report via the existing systems. First of all, the proposed approach contemplates that investment firms would retain the possibility of complying with their transaction reporting obligations with respect to OTC derivatives under MiFID provisions. Second, once EMIR is implemented new IT arrangements will have to be implemented anyway to comply with the new regulatory provisions.

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

As regards the use of CCPs for transaction reporting purposes, CESR believes it might be possible in the future, keeping in mind that more and more categories of OTC derivatives become eligible for mandatory clearing and that CCPs already offer the services of TRs for the transactions that they clear.

In CESR's view Option 1 could not be a preferred solution for arranging transaction and position reporting on OTC derivatives mainly due to the far advanced work on transaction reporting on OTC derivatives through existing transaction reporting arrangements under MiFID and the potential risk arising from the market power of TRs (that come close to natural monopolies).

It should be noted, though, that any fundamental changes to the EC proposal on a Regulation on OTC derivatives, CCPs and trade repositories in the course of the negotiation process may affect the premises of the analysis undertaken by CESR and would require changes to the suggested organisation of transaction and position reporting on OTC derivatives.

Question 2: Do you have any other views on the possible ways to organise transaction and position reporting on OTC derivatives?

11. A small number of respondents suggested other possible ways of organising transaction and position reporting on OTC derivatives.

After carefully analysing and considering the suggestions made, CESR decided not to alter the preferred Option 2 and opt for the solution where transactions on OTC derivatives are reported to TRs (after these will have been established, registered (or recognised for those not located in the EU) and their regulatory regime defined), also proposing that investment firms retain the possibility of complying with their transaction reporting obligations with respect to OTC derivatives under MiFID provisions.

2. Extension of the scope of transaction reporting obligations

Question 3: Do you agree with the extension of the scope of transaction reporting obligation to the identified instruments?

12. The majority of respondents supported the proposal to extend, 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. Two major comments were made by the supporters of the proposal:
 - a. the extension of the scope should be consistent with the changes currently being contemplated for the Market Abuse Directive;
 - b. CESR needs to provide a clear definition (or a precise list) of OTC derivatives that would fall within the scope of reporting obligations;
 - i. Opinions varied whether this should be set at Level 1 or specified through ESMA technical standards;
 - ii. Clarification was requested whether OTC derivatives based on commodities, foreign exchange or interest rates are to be exempted from the reporting regime. The same



request was made in terms of OTC derivatives the value of which is derived from, or which is otherwise dependent upon, multiple equity or multiple debt-related financial instruments except where the multiple financial instruments are all issued by the same issuer.

13. One respondent noted that it is crucial that the same regime applies to all transactions on a given derivative instrument or any equivalent instrument (e.g. CFDs), be they on exchange or negotiated on other trading venues or bilaterally, cleared or non-cleared. It was also underlined that the suspicious transaction reporting obligations under MAD have to also have such a broad scope.

Based on the feedback received, CESR proposed (Ref. CESR/10-1254) that the EC extends, through changes 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. This excludes indices or baskets of securities, apart from derivatives where all the underlying securities are issued by the same entity, e.g. single name credit default swaps.

In the OTC derivatives case, CESR strongly recommended that the exact scope of the instruments would not be exhaustively set out in the reviewed text of MiFID but could be further specified through technical standards to be developed by ESMA. 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 time a new, significant instrument emerges in the EU market or an existing, non-covered instrument acquires a significant supervisory relevance.

CESR suggested that the OTC derivatives initially subject to the reporting obligations would include those covered in CESR's feedback statement on the consultation on "Classification and identification of OTC instruments for the purpose of the exchange of transaction reports among CESR members" (Ref. CESR/09-987):

- a. Options
- b. Warrants
- c. Futures
- d. Contracts for Difference (CfD) and Total Return Swaps (TRS)
- e. Credit Default Swaps (CDS)
- f. Other Swaps
- g. Spreadbets
- h. Complex derivatives

In addition, derivatives that would not fall within plain-vanilla general categories would be reported under a common "complex derivatives" label².

² For further details please see section D of CESR Guidance on "How to report transactions on OTC derivative instruments" (Ref. CESR/10-661).