COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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TECHNICAL ADVICE

CESR Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets

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Executive Summary

The Markets in Financial Instruments Directive (MiFID) came into force on 1 November 2007. It introduced significant changes to the European regulatory framework for secondary markets. CESR initially assessed the impact of these changes in the first half of 2009 and published a report in June 2009. This report on 'impact of MiFID on equity secondary markets functioning' (Ref: CESR/09-355) recommended further work to address some issues identified.

Following the publication of the report, CESR held a series of meetings with representatives from regulated markets (RMs), multilateral trading facilities (MTFs), investment firms, buy-side firms and market data vendors and conducted a fact-finding to obtain information on dark trading taking place on RM, MTFs and investment firms' crossing processes. The information gained fed into the Consultation Paper (CP) on equity markets that CESR published in April 2010 as part of the MiFID review (Ref: CESR/10-394). 76 responses to that consultation, including confidential submissions, have been received. The responses to the CP, together with information received in response to CESR's Call for Evidence on micro-structural issues that was also published in April (Ref: CESR/10-142), informed the technical advice that CESR provides to the European Commission in this report. The data on dark trading taking place on RMs, MTFs and investment firms' crossing systems has been updated with figures for Q1/2010.

The main recommendations addressed in this report are covered by the following headings:

Pre-trade transparency regime for RM/MTFs:

Data from the fact-finding shows that more than 90 percent of trading on organised markets in Europe is pre-trade transparent. CESR recommends retaining the general requirement for pre-trade transparency on organised markets (RM/MTFs). However, exceptions to pre-trade transparency should continue to be allowed under certain circumstances.

In order to provide greater clarity for regulators and market participants and facilitate continuous supervisory convergence, CESR seeks to move from a 'principle based approach' to waivers from pre-trade transparency to an approach that is more 'rule based'. In addition, CESR recommends the Commission provide ESMA with specific powers to monitor and review the pre-trade transparency waivers going forward and to develop binding technical standards in this regard.

Regarding particular waivers, CESR recommends the Commission undertake/commission further analytical work based on empirical data to determine whether the existing large-in-scale (LIS) thresholds should be revised. CESR stands ready to provide the Commission with further assistance in this work, including recommending parameters and reviewing data. CESR also recognises the need for a harmonisation of the treatment of 'stubs' under the LIS waiver and recommends to clarify that venues using the reference price waiver should not embed a fee in the price of trades. With respect to the existing wording of the waivers, CESR continues to work on appropriate clarifications (as were outlined in Annex I of the CP) which may, as appropriate, be included in binding technical standards at a later stage.

In addition, CESR recommends that MiFID be amended to clarify that actionable indications of interest (IOIs) are considered to be orders and as such subject to pre-trade transparency requirements.

Definition of and obligations for systematic internalisers:

CESR recommends the Commission clarify the objective of the systematic internaliser (SI)-regime and consider a broader review of this regime within the MiFID review, including further consideration of whether to establish appropriate thresholds for the material commercial relevance of the activity to the market and whether to retain/remove the price improvement restriction. CESR stands ready to provide the Commission with further assistance in this work in the coming months, as appropriate.

Notwithstanding the recommendation for a broader review, CESR sees value in some clarifications to ensure consistent understanding and implementation of the regime, as well as some specific

amendments to the regime to improve the value of information provided to the market. CESR therefore recommends clarifying the criterion 'according to non-discretionary rules and procedures' in the definition of an SI and (inter alia) to revise the SI-obligations to require two-sided quotes and minimum quote sizes.

Post-trade transparency regime:

CESR recommends retaining the current framework for post-trade transparency but to introduce formal measures to improve the quality of post-trade data, shorten delays for regular and deferred publication and reduce the complexity of the regime. Detailed proposals for binding post-trade transparency standards and guidelines on the obligations for post-trade transparency (as were outlined in Annexes II and III of the CP) are being worked on with the industry and detailed recommendations on this will be provided at a later stage.

As a supplement to the introduction of new standards on data quality and guidelines on trade publication, CESR recommends requiring investment firms to publish their trades through Approved Publication Arrangements (APAs). All APAs would be required to operate data publication arrangements to prescribed standards, as set out in Annex I.

Application of transparency obligations to equity-like instruments:

CESR recommends to enhance the scope of the MiFID transparency regime by applying transparency obligations to equity-like instruments admitted to trading on an RM, including depository receipts, exchange-traded funds and 'certificates' as defined in CESR's advice. These instruments are considered to be equity-like, since they are traded like shares and, from an economic point of view, equivalent to shares. CESR believes that there are benefits for investors stemming from a harmonised pan-European pre-and post-trade transparency regime for these instruments.

Regulatory framework for consolidation and cost of market data:

CESR recognises that significant barriers to the consolidation of post-trade data remain and that, without further regulatory intervention, market forces are unlikely to deliver an adequate and affordable pan-European consolidation of transparency information. CESR therefore recommends that a European consolidated tape be mandated and its main features outlined in MiFID. Regarding the technical implementation, CESR recommends a solution involving the industry within a clear scope and relatively short timeframe set by the Commission and ESMA. The process for the development of the European consolidated tape by the industry should be launched and progress and implementation monitored by ESMA. In case of default at any stage of the process, MiFID should identify a clear course of action and require the establishment of a mandatory single European consolidated tape run as a not-for-profit entity on the basis of terms of reference and governance to be set out by ESMA.

Regulatory boundaries and requirements:

CESR addresses concerns about certain inconsistencies which may have impacted the level playing field. It is recommended that the requirements which apply to RM and MTFs under MiFID be further aligned.

As regards broker crossing systems (BCSs), CESR recommends that a new regulatory regime with tailored additional obligations be introduced for investment firms operating such systems. This would include: notification by investments firms that they operate a BCS; publication of a list of BCSs; a requirement for a generic BCS identifier in post-trade transparency information; publication of aggregate trade information at the level of each BCS at the end of the day; and identification of BCSs in transaction reports. CESR also acknowledges concerns expressed by some market participants and regulators about the speed of growth of BCSs and the potential impact of these OTC markets on price formation in the future. It is therefore recommended to impose a limit on the amount of business that can be executed by BCSs before they are required to become an MTF. CESR stands ready to provide the Commission with assistance in the refinement of these proposals in the coming months, where appropriate.

MiFID options and discretions:

CESR has identified certain options and discretions within MiFID's markets provisions and consulted on the desirability of eliminating them or turning them into rules. CESR recommends retaining the discretion regarding the use of pre-trade transparency waivers and to retain the role of CESR/ESMA in considering the use of the waivers to ensure their consistent and reasonable use. Taking the feedback from the consultation into account, the discretion of Member States to choose some of the criteria to define liquid shares and the discretion regarding requirements for admission of units in collective investment undertakings to trading on an RM should also be retained. However, CESR sees merit in converting the discretion of Member States under Article 22(2) of MiFID into a rule by prescribing that investment firms comply with their obligation to make an unexecuted client limit order immediately public by transmitting it to a pre-trade transparent RM/MTF.

Micro-structural issues:

CESR sets out the key themes emerging from its Call for Evidence on micro-structural issues and proposes an action plan for further work in this area. CESR also recommends the Commission amend MiFID to include specific references to ESMA competencies to develop binding technical standards on RMs'/MTFs' organisational requirements regarding sponsored access, co-location, fee structures and tick sizes, as appropriate. Pending the revision of MiFID, CESR will consider dealing with some of these issues under CESR guidelines.

Other MiFID provisions related to secondary markets:

Since the activity of MTFs in host Members States has become increasingly significant post-MiFID, CESR recommends extending the obligation in Article 56(2) of MiFID for competent authorities to cooperate, such that it extends to the activities of MTFs as well as RMs.

1. Introduction

1. The Markets in Financial Instruments Directive (MiFID), a major part of the European Union's Financial Services Action Plan (FSAP), came into effect on 1 November 2007. It introduced significant changes to the European regulatory framework, taking account of developments in financial services and markets since the Investment Services Directive (ISD), which it replaced, was implemented in 1995.

2. In November 2008, CESR published a Call for Evidence (Ref. CESR/08-872) on the impact of MiFID on secondary market trading in equities. In response, thirty-nine submissions (including four confidential submissions) and three confidential annexes were received from a range of European trade associations, RMs, MTFs, market data vendors, investment firms and other interested parties. CESR also organised a roundtable at the beginning of 2009 which attracted a broad range of market participants.

3. In June 2009, CESR published its report on the 'impact of MiFID on equity secondary markets functioning' (Ref. CESR/09-355). This report set out its findings and recommended further work to address issues identified. Following the publication of the report, CESR held a series of meetings with representatives from RMs, MTFs, investment firms and market data vendors. CESR also received further written representations from RMs, issuers, high frequency traders and market data vendors. Finally, CESR conducted a fact finding to obtain information on dark trading taking place on RMs, MTFs and investment banks' internal crossing processes.

4. In developing proposals for the Commission's MiFID review, it is important to keep in mind relevant changes in the operation of trading and market structure. Technological advance has continued to facilitate new developments in markets, an important example being the strong growth in algorithmic and high frequency trading. A Call for Evidence was published in this respect on 1 April 2010 for a one month call for comments. CESR will continue work on these micro-structural issues in parallel to the MiFID review.

5. This report is organised as follows. Section 2 describes issues relating to the MiFID pre- and post-trade transparency regime and puts forward recommendations aimed at addressing concerns raised following the implementation of MiFID including, in particular, lack of clarity of the MiFID pre-trade transparency waivers and quality of post-trade transparency information. Section 3 considers so-called 'equity-like' financial instruments and proposes to extend MiFID transparency obligations to such instruments. Section 4 (and Annex I) considers remaining barriers to consolidation of transparency information and puts forward two possible approaches to promote consolidation. Section 5 assesses whether there is a case for re-aligning regulatory boundaries and requirements and proposes to better align requirements between RMs and MTFs and puts forward proposals for new requirements for investment firms' crossing processes. Section 6 identifies options and discretions in MiFID which relate to RMs, MTFs and SIs and where a more harmonised approach might be desirable. Section 7 summarises the comments CESR received in response to its Call for Evidence on micro-structural issues and outlines a proposed action plan for CESR to take forward. Finally, Section 8 addresses other issues related to the MIFID markets provisions.

2. Transparency

6. A key objective of MiFID is to promote competition between trading venues for execution services so as to increase investor choice, encourage innovation, lower transaction costs, and increase the efficiency of the price formation process on a pan-European basis. A high degree of transparency is an essential part of this framework, so as to ensure a level playing field between trading venues so that the price discovery mechanism in respect of particular shares

is not impaired by the fragmentation of liquidity, and investors are not thereby penalised[1]. Transparency also facilitates the application of the best execution obligations.

7. In developing policy options for transparency, it has been assumed that the existing MiFID framework for competition and best execution obligations remain unchanged.

2.1 Pre-trade transparency

2.1.1 Organised trading platforms (RMs and MTFs)

8. MiFID introduced pre-trade transparency obligations for shares admitted to trading on an RM with the aim of providing the wider investing public with access to information on current opportunities to trade on a timely basis. Pre-trade transparency obligations were also devised as a way of mitigating the potential adverse impact of a fragmentation of markets and liquidity, ensuring a level-playing field between trading venues, promoting the efficiency of the overall price formation process on a pan-European basis and assisting an effective operation of best execution obligations[2].

9. MiFID places the same pre-trade transparency obligations on both RMs and MTFs[3]. This regime requires RMs/MTFs to make public, on reasonable commercial terms, details of best bids and offers and the depth of trading interests at these prices.

10. MiFID also allows competent authorities to grant RM/MTF waivers[4] from pre-trade transparency obligations for certain types of orders and systems. There are four waivers from pre-trade transparency obligations, for:

    a. orders that are large in scale;

    b. reference price systems;

    c. systems which formalise negotiated transactions; and

    d. orders held in an order management facility

11. MiFID recognises that there are circumstances where exemptions from pre-trade transparency obligations are necessary. It explains that the waivers have been set out bearing in mind the need to ensure a high level of transparency and to ensure that liquidity on trading venues and elsewhere is not impaired as an unintended consequence of obligations to disclose transactions and thereby to make risk positions public.

12. The CESR fact finding shows that more than 90 per cent of trading on organised public markets in Europe is pre-trade transparent. The data indicates an increase in trading on organised public markets without pre-trade transparency in 2009, compared to 2008 from a quarterly average of 6.4 per cent of total EEA trading on organised public markets in 2008 to a quarterly average of 8.9 per cent in 2009 (see Table 1 below). The fact finding also indicates that the majority of trading without pre-trade transparency on organised markets takes place using the waivers for negotiated trades and for orders that are large in scale.

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[1] Article 5 of the MiFID Implementing Regulation

[2] The situation prior to MiFID is described by ESME, Fact finding regarding the developments of certain aspects of pre-trade transparency in equities under MiFID, p. 5et seq.

[3] See Articles 29(1) and 44(1) of MiFID. Pre-trade transparency obligations of systematic internalisers are laid down in Article 27 of MiFID and Articles 22 to 26 of the Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for purpose of that Directive, OJ L 241, 2.9.2006, p.1 ("MiFID Implementing Regulation").

[4] See Articles 29(2) and 44(2) of MiFID and Articles 18 to 20 of the MiFID Implementing Regulation.

Table 1: Trading in EEA shares executed under MiFID pre-trade transparency waivers[5]

	2008				2009				2010
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1****
Trading under pre-trade waivers*	282.3	263.4	213.0	182.7	146.9	203.9	206.8	240.6	222.6
All Trading in EEA shares on RMs and MTFs*	4234.6	3804.1	3692.5	2912.7	1934.1	2227.8	2289.8	2442.5	2624.8
Total as a % of all trading in EEA shares on RMs and MTFs	6.7%	6.9%	5.8%	6.3%	7.6%	9.2%	9.0%	9.8%	8.5%

*Values are in bn Euros
**Q1 2010 figures do not include data from Poland
Sources: (1) Value of trading on RMs and MTFs without pre-trade transparency: Member State competent authorities; (2) All trading in EEA shares on RMs and MTFs: Thomson Reuters

2.1.1.1 Waivers from pre-trade transparency

13. Post-MiFID, trading platforms have availed themselves of pre-trade transparency waivers and many have been innovative in developing proposals which they felt responded to user demands and were within the MiFID scope. However, there are some concerns that the regime does not operate satisfactorily in a number of areas. There have been some interpretation issues on the scope of the waivers, which have resulted in practical difficulties. This lack of consistency and certainty is seen by trading platforms and their users as endangering the level playing field.

14. CESR has recognised that there are difficulties with the application of the waivers and has agreed to a number of initiatives. In April 2009, it launched a procedure whereby competent authorities submit proposals for the use of the waivers for discussion within CESR (the CESR waiver process). This process aims to achieve supervisory convergence and to ensure a consistent application of the waivers. The results of CESR's assessments of order types and order matching methodologies proposed by operators of RMs/MTFs are published on the CESR website in the document 'Waivers from Pre-Trade Transparency Obligations under the Markets in Financial Instruments Directive (MiFID)'[6].

15. More fundamentally, there has been substantial debate amongst regulators and market participants about the structure of the waivers. In particular, some participants contend that the waivers were designed in 2006 to match the market structure that existed at that time, but are less suited to the competitive and innovative market structure facilitated by the introduction of MiFID.

16. Many trading platforms and their users consider that the waivers are too narrow, do not provide for market developments, and are stifling innovation. It has also been suggested that it would be desirable to have a more dynamic transparency regime which responds to innovation and market developments. On the other hand, some other trading platforms and market participants consider that the use of waivers adversely affects the efficiency of the price formation process.

[5] These figures do not include trading under the waiver for order management facilities. This table and the table on the Large in Scale Waivers do not include information from the Estonian and Icelandic FSAs.
[6] See CESR/09-324 available at www.cesr.eu/popup2.php?id=5754.

Proposal

17. CESR considered carefully the most appropriate framework for pre-trade transparency in a post-MiFID environment and concluded that it would be desirable to:

    a. retain the generic requirement that all trading on organised markets (RMs/MTFs) must be pre-trade transparent;

    b. continue to allow exceptions to pre-trade transparency in certain circumstances; and

    c. seek to move from a 'principle based' approach to waivers from pre-trade transparency to a 'rule based' approach where a more precise description of the waivers would provide greater clarity for market participants and competent authorities and facilitate continuous supervisory convergence with regard to waivers within CESR/ESMA, taking into account financial innovation.

Summary of Feedback

18. Respondents almost unanimously supported the generic approach to pre-trade transparency described in the CP. Nearly all respondents supported a move from a principle-based to a rule-based approach to the pre-trade transparency waivers, which would provide greater clarity for market participants and competent authorities. However, about half of the respondents supporting the rule based approach stressed the need to retain some flexibility to adjust to market developments and recommended that there be a sufficiently robust process for CESR/ ESMA to take into account financial innovation and evolve these rules.

Recommendation

19. CESR recommends retaining the generic approach to pre-trade transparency outlined above and moving from a principle-based to a rule-based approach to pre-trade transparency waivers. When developing the rule-based approach, the current assessments of order types and order matching methodologies, as published in CESR's document 'Waivers from Pre-Trade Transparency Obligations under the Markets in Financial Instruments Directive (MiFID), should be the starting point for discussions.

20. Furthermore, CESR recommends that the Commission give ESMA the power to undertake regular (e.g. annual) reviews of the use of the pre-trade transparency waivers (including the proportion of trading taking place under them) and to form binding technical standards to adjust the waivers to provide certainty about their interpretation or to reflect market developments, where appropriate. These powers should relate to technical points/application of the waivers as opposed to points of overarching policy.

21. With respect to the existing wording of the waivers, CESR continues to work on appropriate clarifications (as was outlined in Annex I to the CP) which may, as appropriate, be included in binding technical standards at a later stage.

2.1.1.2 Large in scale waiver

Background

22. The large in scale (LIS) waiver is designed to protect large orders from adverse market impact. MiFID recognises that mandatory public exposure for large orders makes the costs of execution higher than if the order is not displayed publicly.

23. MiFID sets out order size thresholds (fixed amounts expressed in Euros) above which RMs and MTFs do not have to display orders submitted to their systems. There are 5 thresholds, one for each of the 5 liquidity bands into which shares are placed on the basis of their average daily order book turnover (ADT) over the previous calendar year.

24. In 2008, an average of 3.1% of trading on European RMs and MTFs took place using the LIS waiver. The percentage rose to 4.2% in 2009 (see Table 2 below). However, the whole of this increase, and approximately 75% of all trading using this waiver in 2009, is attributable to trading in one jurisdiction. Elsewhere, the waiver is used relatively little, accounting for only one per cent of overall trading.

Table 2: Trading in EEA shares executed under the large in scale waiver

	2008				2009				2010
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Trades under LIS waiver*	115.8	148.1	106.1	86.1	63.5	100.6	90.4	119.6	99.5
Total as a % of all trading in EEA shares on RMs and MTFs **(Percentage excluding Member State that is the main user of waiver)**	2.7% (1.0%)	3.9% (1.5%)	2.9% (0.9%)	3.0% (0.8%)	3.3% (0.7%)	4.5% (1.6%)	3.9% (0.9%)	4.9% (0.8%)	3.8% (1.1%)

*Values are in bn Euros
Sources: (1) Value of trading on RMs and MTFs without pre-trade transparency: Member State competent authorities; (2) All trading in EEA shares on RMs and MTFs: Thomson Reuters

25. CESR considers that a waiver from pre-trade transparency for orders that are large in scale is still justified to allow investors to avoid market impact when executing large trades. However, CESR sought views on options for the calibration of the thresholds for large in scale orders and clarifications on the scope of this waiver.

Large in scale – thresholds

26. Many trading platforms contend that the gap between the average order size and the LIS thresholds (set in 2006) is too wide and that as a result market participants do not get adequate protection from market impact when submitting orders. MiFID sets the threshold for large orders in the most liquid shares at €500 000, stepping down in stages to €50 000 for large orders in the least liquid shares. By comparison, the average trade size on the London Stock Exchange was €22 266 in 2006 compared with €11 608 in 2008 and €9 923 in 2009[7]. These trading platforms hold that the thresholds for large orders should take into account changes in average trade size.

27. It is also claimed that the size of the thresholds in the current regime has the effect of encouraging market participants to execute trades away from RMs and MTFs. However, this claim is not clearly evidenced by any corresponding increase in the overall percentage share of OTC trading.

28. The main question is whether the current thresholds under the LIS waiver are appropriate and strike a proper balance between the general benefit of transparency and necessary protection from adverse market impact. CESR recognises that factors other than current order sizes are relevant in assessing whether MiFID existing thresholds provide adequate protection

[7] London Stock Exchange website: www.londonstockexchange.com Factsheets and News. (NB: these figures are based on an exchange rate of 1 GBP = 1.15 EUR)

for large orders. For instance, development of algorithmic trading and ability to trade shares on multiple platforms may need to be taken into account, as they may have rendered the execution of large orders more complex without necessarily affecting their market impact. As noted above, the volume of trading that occurs under the waiver has so far been relatively high in one Member State but very low elsewhere.

29. CESR sought views on the current LIS regime and requested that respondents provide a specific proposal for any reduction in the current thresholds.

Feedback and discussion

30. Respondents were almost evenly divided on the need to amend the LIS thresholds. Some considered that the current calibration was appropriate and should be maintained (a small number considered that the thresholds should be increased). Others considered that the current calibration should be changed and reduced. Some supported the suggested 25% reduction, others believed a more significant reduction was necessary (up to 75%). CESR received a limited number of specific proposals for reducing the LIS thresholds.

31. CESR does not consider it received enough data from market participants in order to form a view on this waiver. Further work, based on empirical data, is needed before a final decision can be taken on the LIS thresholds. CESR notes comments that the reduction in trade or order size is not in itself a sufficient rationale for amending the LIS thresholds. CESR also notes comments that the thresholds should be reduced and that further assessment is needed to determine the potential market impact generated by a large order in today's market environment compared to 3 or 4 years ago.

Recommendation

32. CESR recommends that the Commission undertake/commission further analytical work based on empirical data to better determine whether the existing LIS thresholds need to be reduced, and if so, the magnitude of the potential recalibration. This work should be based on specific parameters, including a reliable reference period and the market impact of an order that would be considered acceptable. It should also take account of the specific characteristics of national markets. CESR stands ready to provide the Commission with assistance in this work, including recommending parameters and reviewing any outputs.

33. In addition, CESR recommends that the Commission give ESMA the power to monitor the waiver on an ongoing basis (which would include periodic review of whether the LIS thresholds remain appropriate and whether there should be a cap on volumes executed under the waiver) and to develop binding technical standards in this regard in the future, if needed.

Large in scale – treatment of residual orders ('stubs')

34. The current scope of the large in scale waiver for large orders that do not get fully executed is not clear. The specific situation that arises is where an initial large order satisfies the relevant LIS threshold but, when partially filled/executed, is reduced to a 'stub' that falls below the relevant threshold.

35. Some CESR members have allowed 'stubs' to retain the protection of the LIS waiver. Trading platforms in these jurisdictions are not required to cancel or display partially filled large orders that are below LIS thresholds.

36. While there are divergent views on this issue, CESR recognises the benefit of a consistent approach and for this to be clarified in MiFID. Accordingly, CESR sought views on whether a 'stub' should be displayed if its residual size is below the relevant LIS threshold.

Feedback and discussion

37. A majority of respondents supported allowing stubs to remain dark. For those respondents, this option is the most consistent with the purpose of the LIS waiver, allows working a large order over the course of the day, avoids duplication of settlement charges in case the stub would have to be redirected to a lit venue, and reduces market impact for subsequent block orders in the same name. It is noted that asset managers monitor execution on an ongoing basis and make decisions about stubs rather than just leaving an unexecuted order in a market. Even if there is some theoretical deterioration in pre-trade transparency, the cost of any other option is considered to far outweigh any benefit. It is typically agreed by those respondents that, where a stub is modified by the trader itself, the LIS waiver should no longer apply.

38. Other respondents supporting stubs becoming lit were of the view that the intention of the LIS waiver is to mitigate adverse impact on large orders and considered that there are no grounds for a stub to benefit from this waiver as it will not generate the same market impact as a large order. Some respondents also stressed that allowing residual orders below the LIS threshold to remain undisclosed would create an inconsistency with the transparency requirements for new orders of the same size. One of these respondents further stressed that, if stubs remain dark, it allows market participants to circumvent regulation for the LIS waiver.

39. The majority of competent authorities in CESR share the view that, where large orders are submitted to a venue under the LIS waiver and are subsequently partially executed, the remaining stubs should become lit, believing that price formation is otherwise distorted and, in the case of lit venues, orders of equal size should be treated the same irrespective of whether they are the residual portion of a partly-executed large order. A minority of competent authorities believe stubs should be allowed to remain dark on the grounds that, if they become lit, they will simply be deleted or, if appearing on the book immediately after an execution, may effectively reveal the original size of the large order.

Recommendation

40. CESR believes that the current wording of the LIS waiver is ambiguous with regard to the treatment of stubs. CESR recommends strongly that the Commission provide clarification: that either the waiver does not apply to stubs (as per the majority view within CESR) or that the waiver does extend to stubs.

41. More generally, CESR believes it is important that the Commission also considers when amending MiFID to harmonise its application to 'stubs' what the LIS waiver is intended to achieve apart from the avoidance of excessive market impact of a large order. As the feedback to the consultation paper and the divergent views within CESR indicate, there are currently differing views on the underlying intention behind this waiver and there would be value in clarifying its aim.

2.1.1.3 Reference price waiver

Background

42. The reference price waiver is designed for passive price taking systems that match supply and demand without price discovery and at a fixed reference price (e.g. the opening or closing price, or at a reference price recorded at some other point during the day). Reference price systems were operated in some Member States prior to the implementation of MiFID. Post-MiFID the business of trading systems using this methodology has evolved, from satisfying demand for trading primarily in less liquid shares to trading in the most liquid part of the market, and from offering single venue reference price systems to offering trading referenced to consolidated/multiple venue prices (e.g. a reference price related to the European Best Bid and Offer).

43. The CESR fact finding shows that the volume of trading executed in reference price systems is currently lower than trading under the LIS waiver or the negotiated trade waiver. Only four European jurisdictions have granted the waiver, and trading under that waiver accounted for 0.1% of all trading in EEA shares on RMs/MTFs in 2008. Trading using this waiver has increased since 2008, but it remains a small proportion of total trading in EEA shares on organised public markets, accounting for 0.5% on average in 2009, and 1.0% in the first quarter of 2010 (see Table 3 below).

Table 3: Trading in EEA shares executed under the reference price waiver

	2008				2009				2010
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Trading under reference price waiver*	3.1	3.5	3.3	3.8	5.1	7.7	12.9	21.0	25.9
Total as a % of all trading in EEA shares on RMs and MTFs	0.1%	0.1%	0.1%	0.1%	0.3%	0.3%	0.6%	0.9%	1.0%

*Values are in bn Euros

Sources: (1) Value of trading on RMs and MTFs without pre-trade transparency: Member State competent authorities; (2) All trading in EEA shares on RMs and MTFs: Thomson Reuters

44. Post-MiFID, reference price systems have gained in popularity and, in particular, are provided by new entrant MTFs, although not exclusively. For some, it is their only trading model. Broadly, the policy rationale for the reference price waiver remains. However, market developments have moved beyond CESR's observation in its previous technical advice to the EC in April 2005. Non-disclosure by these systems is no longer primarily due to the concern that the publication of orders, especially in the less liquid shares for which the systems were most frequently used, would increase the incentive to manipulate the continuous market before the reference price was fixed.

45. Some concerns have been raised that reference price systems are being used to execute small orders and it has been suggested that this is inconsistent with the general intention of the waivers to provide protection against market impact. On the other hand, some market participants have expressed concerns that the reference price waiver is overly restrictive and provides little scope for market developments and innovation. They consider it would be beneficial to have more flexibility, allowing more scope for execution within the (visible) market spread.

46. CESR sought views on whether the waiver should be amended to include minimum thresholds for orders submitted to a reference price system, and any other comments on this waiver.

Feedback and discussion

47. Almost all respondents wanted the reference price waiver to be retained. Most were against the introduction of a minimum threshold for orders entered into a reference price waiver. Their main argument was that the purpose of the waiver is not to protect orders from market impact but to allow for "passive pricing". It was noted that the introduction of a minimum threshold would no longer allow small or "child" orders to be executed on reference price systems and would either lead to increased execution costs for small/child orders on lit venues or discourage execution of such orders on organised venue altogether. It was also noted that reference price systems typically offer the possibility for participants to set a minimum execution size for their orders.

48. Other respondents supported the introduction of a minimum threshold in order to protect price formation, stay close to the original intention of the waiver (which they viewed as being to avoid price impact for large orders), and avoid transactions in price referencing systems from "free riding" on price discovery in pre-trade transparent venues. These concerns are shared by some CESR members, especially in the face of growing usage of this waiver. Some respondents proposed minimum thresholds, including a minimum size of €2,000 and up to 80% of the large-in-scale threshold.

49. Some respondents were in favour of a more flexible use of the reference price waiver, suggesting that crossing anywhere within the spread (as opposed to just at mid-point, the best bid or the best offer) be allowed. Others argued that crossing within the spread should only occur at mid-point, with one considering that no execution should take place on a dark system at a price that was already displayed on a lit market. The same respondent also stated that a limit should be imposed on the amount of dark trading in any given instrument that could take place on any individual trading venue.

50. CESR is of the view that venues making use of the reference price waiver should execute trades at gross prices and not incorporate any embedded fee in the price. This is to ensure that the prices published in trade reports clearly correlate with the venue's stated pricing methodology (e.g. executions taking place at mid-point).

Recommendation

51. CESR recommends that the Commission clarify that venues using the reference price waiver must not embed a fee in the price of trades.

52. CESR also recommends that the Commission give ESMA the power to monitor the waiver on an ongoing basis (which would include periodic review with respect to pricing methodologies, whether there should be mandatory minimum order sizes and whether there should be a cap on volumes executed under the waiver), and to develop binding technical standards in this regard in the future, if needed. According to some CESR members, the Commission should also consider including a minimum order size in the reference price waiver as part of the MiFID review and only leave the adjustment of that minimum order size to ESMA binding technical standards.

2.1.1.4 Negotiated trade waiver

Background

53. The waiver for negotiated trades provides an exemption from pre-trade transparency for transactions that are not accessible to other members of an RM or MTF other than the one(s) that have pre-negotiated the trade. The rationale for the waiver was - among others - to enable intermediaries to achieve best execution for their clients in cases where it would not be in the interest of the client to enter the order into the order book because a better quality of execution might be achieved outside the order book (e.g. when the order book cannot fill the whole order). The negotiated trade waiver is also needed in cases where it is not possible to trade certain orders through a central trading mechanism e.g. where an order book has a significant minimum order size, permits the trading of only round lots or imposes other standard conditions such as settlement that some types of orders cannot meet. Negotiated trades have traditionally also been used for principal transactions which are subject to conditions other than the current market price such as principal VWAP or portfolio trades.

54. Negotiated trades existed pre-MiFID in many Member States. The waiver is used post-MiFID particularly by RMs.

55. In 2008, an average of 3.2% of trading on European RMs and MTFs took place using the negotiated trade waiver. There was an increase to an average of 4.2% of total EEA trading on RMs and MTFs in 2009 (see Table 4 below).

Table 4: Trading in EEA shares executed under Negotiated Trade Waiver

	2008				2009				2010
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1****
Trades under negotiated trade waiver*	163.4	111.9	103.6	92.8	78.4	95.6	103.5	100.0	97.1
Total as a % of all trading in EEA shares on RMs and MTFs	3.9%	2.9%	2.8%	3.2%	4.1%	4.3%	4.5%	4.1%	3.7%

*Values are in bn Euros
**Q1 2010 figures do not include data from Iceland and Poland
Sources: (1) Value of trading on RMs and MTFs without pre-trade transparency: Member State competent authorities; (2) All trading in EEA shares on RMs and MTFs: Thomson Reuters

56. CESR took the view that the negotiated trade waiver should be retained subject to clarifications and did not put forward any specific proposals on the waiver for negotiated transactions.

Feedback

57. The outcome of the consultation broadly supported this view. A majority of respondents stressed the need for clarification of the waiver as some venues offered two different post trade transparency services - one for negotiated trades, which were subject to the venue's rule book, and another that was simply a printing service for OTC trades – and it was important for participants to know which they were using. Three respondents stressed that the negotiated trade waiver unfairly discriminated against trading systems that either did not have a displayed order book or did not offer continuous trading.

Recommendation

58. CESR recommends the existing waiver for negotiated transactions be retained, recognising that further clarification on the scope of this waiver may be desirable (as per paragraph 21 above).

59. CESR also recommends that the Commission give ESMA the power to monitor the waiver on an ongoing basis (including with respect to such clarifications and whether there should be a cap on volumes executed under the waiver) and to develop binding technical standards in this regard in the future, if needed.

2.1.1.5 Order management facility waiver

Background

60. This waiver provides an exemption from pre-trade transparency for orders held in an order management facility, 'pending their being disclosed to the market'. The rationale for this waiver is that order management facilities provided by RMs/MTFs help intermediaries and their clients in executing their orders in the most efficient way. CESR's view in the technical advice it provided to the Commission during the formulation of MiFID implementing measures was that the provision of these facilities should be left to the discretion of RMs and MTFs.

61. CESR did not conduct a fact finding exercise to gather data on the use of this waiver. Most (if not all) RMs make use of this waiver for iceberg, stop market and/or stop limit orders. Some MTFs have also introduced similar functionalities.

62. Some trading platforms have raised concerns that the waiver is overly restrictive, does not allow for innovation and prevents them from providing the same order types and functionalities as investment firms. They claim that this is creating an unlevel playing field.

63. One way to address level playing field concerns between investment firms and RMs/MTFs would be by 'levelling up' the disclosure requirements for investment firms. This would require all orders submitted by investment firms to RMs/MTFs to be publicly displayed. Among other things, this would result in investment firms not being allowed to submit market orders or other orders with a zero time in force (e.g. IOC, FOK).

64. Another way to address level playing field concerns between investment firms and RMs/MTFs would be by 'levelling down'. This means that RMs/MTFs would be permitted to offer the same functionality with their order management facilities as investment firms can arrange. This would allow purely dark orders (in price and size) to be managed by RMs/MTFs that would never appear in the order book or be visible to market participants before execution.

65. CESR did not put forward any specific proposals on the waiver for order management facilities.

Feedback and discussion

66. Most respondents were content with the current application of the waiver or did not provide specific proposals for amendments. Some reiterated however their concerns about a restrictive application and an unlevel-playing field between order management systems operated by RMs/MTFs and those operated by investment firms.

67. CESR considers that the business conducted by RMs/MTFs is different to that of investment firms. There is therefore little ground to suggest that RMs/MTFs should operate under the same rules as a broker dealer and that the order management waiver be amended to address potential level playing field concerns in the use of this waiver.

Recommendation

68. CESR recommends that the existing waiver for order management facilities be retained, recognising that further clarification on its conditions may be desirable (as per paragraph 21 above).

69. CESR also recommends that the Commission give ESMA the power to monitor the waiver on an ongoing basis (including with respect to such clarifications) and to develop binding technical standards in this regard in the future, if needed.

2.1.1.6 Indications of interest (IOIs)

Background and Call for Evidence

70. In April 2010, CESR issued a Call for Evidence on micro-structural issues in the equity markets[8]. Among other issues, CESR sought views on indications of interest (IOI). An IOI is the name commonly used to refer to a message sent between investment firms to convey information about available trading interest. IOIs are also used by dark pools to attract order flow and to maximise trading opportunities by enabling investors to find the contra-side of

[8] CESR/10-142 – CESR Call For Evidence on Micro-structural issues of the European equity markets, 1 April 2010.

orders. The information provided in an IOI can include the symbol of the security, the side (i.e. buy or sell) and volume/price of trading interest.

71. MiFID requires pre-trade transparency as an overarching principle for RMs/MTFs. It is unclear where IOIs stand within this framework. In addition, MiFID requires RMs/MTFs to have non-discretionary rules for fair and orderly trading. If IOIs were used to provide information to a select group of market participants to the exclusion of others, this may be inconsistent with the intention of MiFID. The CESR Call for Evidence invited comments as to whether MiFID should be amended to clarify that actionable IOIs should be subject to pre-trade transparency requirements and whether there would be circumstances where it would be appropriate for IOIs to be provided to a selected group of market participants.

Feedback and discussion

72. Respondents made a clear distinction between IOIs used OTC for bilateral transactions and IOIs used on organised trading venues. It was noted that electronic communication methods (including IOIs) are widely used to send information about available trading interest to selected counterparties as a way of finding the opposite side of a trade in large transactions. These methods existed pre-MiFID.

73. Generally, respondents indicated that it is not common for an RM/MTF to offer an IOI functionality. A large majority agreed that actionable IOIs sent from an RM/MTF must be subject to the pre-trade transparency regime and very few respondents believed that there could be limited circumstances where the use of selective information by RM/MTFs would be appropriate.

Recommendation

74. CESR recommends that MiFID be amended to clarify that an actionable IOI (i.e. an indication of interest that includes all necessary symbols (e.g. side (buy or sell), size, price) to agree on a trade is to be considered as an order and subject to applicable pre-trade transparency requirements. As part of this, CESR recommends that the Commission make clear actionable IOIs may not be used within a trading system such that they are transparent to direct participants without being made public. CESR believes that actionable IOIs should be visible to all or dark to all, and there should be no scope for a trading venue's direct participants and the public to be treated differently.

2.1.2 Systematic internaliser regime

Background

75. MiFID was the first EU directive to introduce the concept of specific regulation for systematic internalisation. Although the basic concept is applicable regardless of asset class, MiFID obligations attaching to SIs relate to the trading of shares. The core of these requirements, which are set out in Article 27 of the directive, is for SIs to publish firm quotes in shares that are classified as 'liquid' under MiFID when dealing in sizes up to standard market size.[9]

76. In the CESR Call for Evidence, questions were raised on the small number of investment firms currently classified as SIs and identified as such in the CESR MiFID database. To date, 10 investment firms have informed their home Member State regulators that they carry out systematic internalisation. CESR has no view on what should be the appropriate number of SIs in Europe. The number of SIs may just not be higher. Another possible reason may be difficulties with the practical application of the SI definition in various Member States. There are also issues regarding the way in which SIs have been fulfilling their quoting obligations.

[9] Standard market sizes are set out in the MiFID Implementing Regulation, Annex II, Table 3.

77. CESR identified the following key issues relating to the SI regime:

a. Whether or not the SI definition requires clarification.

b. Whether or not the SI obligations should be recalibrated to ensure that they are meaningful and add value for market users.

2.1.2.1 Criteria for determining whether an investment firm is a systematic internaliser

78. MiFID Article 4(1)(7) defines a systematic internaliser as 'an investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside a RM or MTF.

79. Article 21(1) of the MiFID Implementing Regulation sets up further criteria indicating under which conditions the activity of a systematic internaliser is to be considered as 'organised, frequent and systematic':

a. the activity has a material commercial role for the firm, and is carried out in accordance with non-discretionary rules and procedures;

b. the activity is carried on by personnel, or by means of an automated technical system, assigned to that purpose, irrespective of whether those personnel or that system are used exclusively for that purpose;

c. the activity is available to clients on a regular or continuous basis.

80. At present, the main problems with the definition rest in Article 21(1)(a) of the MiFID Implementing Regulation. The reference to non-discretionary rules may provide scope for firms to decide that any discretion they exercise in determining whether or not to execute client orders against own account or whether or not to offer price improvement leaves them outside the scope of the definition. However, it should be noted that a firm should always use discretion when deciding whether or not to execute a client order against its own account as the firm has to meet best execution obligations. In addition, the non-discretionary element of a SI is a relevant component of the definition to avoid including ad hoc transactions that would not be systematic.

81. The materiality criteria also offer scope for firms and regulators to adopt different views as to whether a firm falls within or outside the definition. In expanding on Article 21(1)(a), Recital 15 of the Regulation states that: '*An activity should be considered as having a material commercial role for an investment firm if the activity is a significant source of revenue, or a significant source of cost. An assessment of significance for these purposes should, in every case, take into account the extent to which the activity is conducted or organised separately, the monetary value of the activity, and its comparative significance by reference both to the overall business of the firm and to its overall activity in the market for the share concerned in which the firm operates. It should be possible to consider an activity to be a significant source of revenue for a firm even if only one or two of the factors mentioned is relevant in a particular case*.' On this basis, firms have a degree of flexibility in assessing whether activity that could be considered as organised is material either in terms of monetary value of the activity or its significance in terms of the firm's overall activity or role in the market.

82. CESR considers it important that the criteria defining whether or not a firm falls within the SI regime should be as clear as possible. Accordingly, CESR sought views on whether the SI definition could be made clearer by:

a. removing the reference to non-discretionary rules and procedures in Article 21(1)(a) of the MiFID Implementing Regulation; and

b. providing quantitative thresholds of significance of the business for the market to determine what constitutes a 'material commercial role' for the firm under Article 21(1)(a) of the MiFID Implementing Regulation.

Feedback and discussion

83. There were divided views on whether the SI definition would be made clearer by removing the reference to non-discretionary rules and procedures. Similarly, there were varying opinions on whether quantitative thresholds of the business for the market should be introduced to determine whether SI business represented a "material commercial role" for a firm. In particular, some considered that materiality to the market was a more important factor to consider when determining whether a firm was an SI.

84. CESR has considered whether further clarity on the SI criteria may be provided by clarifying the reference to 'non-discretionary rules and procedures'. In the context of the SI regime, CESR considers that 'non-discretionary rules and procedures' refers to a set of pre-defined, common standards developed by the investment firm for providing a service such that it does not differentiate between comparable clients. In other words, based on the categorisation of its clients the investment firm does not exercise discretion regarding access to this service and provides the same prices for the same volume of trading interest in the same market situation, irrespective of the individual client within its categorisation.

85. CESR has also considered whether further clarity may be provided by removing the reference to 'non-discretionary rules and procedures' from the SI definition and making it part of the SI requirements/obligations. However, CESR notes comments from respondents that the non-discretionary criterion is necessary in the SI definition to distinguish this activity from other investment firm business and that such an amendment has the potential to broaden the scope of the regime beyond its original intention. For example, investment firms may legitimately exercise discretion when dealing on own account with wholesale counterparties by varying their pricing depending on the individual characteristics of the counterparty (e.g. perceived counterparty risk).[10] CESR does not consider that the SI regime was intended to apply to this type of business.

86. More generally, a number of respondents questioned whether the SI regime was delivering benefits to the market and suggested that the underlying regulatory objective should be reviewed. In addition, some considered there was insufficient clarity about the overall regulatory intention of the SI regime to enable full consideration of CESR's proposed amendments.

87. Broadly, CESR considers that the regulatory objective of the SI regime is to provide transparency and investor protection (particularly for non-professional investors). To ensure that the regime was delivering on these objectives, CESR put forward some specific proposals based on the application of the existing provisions in MiFID. However, CESR notes the general comments on the intention of the regime and recognises that it may be necessary for a more fundamental consideration of the overall regulatory intention of the SI regime.

88. Based on these considerations, CESR does not believe it is appropriate to recommend fundamental changes to the SI criteria before a broader review has taken place as per the recommendation below. However, CESR does consider that some operational/technical changes would be beneficial at this time, which are set out below in Section 2.1.2.2.

Recommendation

89. As noted above, CESR recommends the Commission consider a broader review of the SI regime as part of the MiFID review that would include further consideration of:

    a. whether appropriate thresholds should be established to determine whether activity has material commercial relevance to the market; and

[10] Recital 53 of MiFID states that it is not the intention of this Directive to require the application of pre-trade transparency rules to transactions carried out on an OTC basis, the characteristics of which include that they are ad-hoc and irregular and are carried out with wholesale counterparties and are part of a business relationship which is itself characterised by dealings above standard market size, and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser.

b. whether price improvement restrictions are still appropriate for SIs when dealing with orders up to retail size.

CESR stands ready to provide the Commission with further assistance in this work.

90. Regarding the criteria for determining whether an investment firm is a SI, CESR recommends:

a. To clarify the reference to 'non-discretionary rules and procedures' in Article 21(1)(a) of the MiFID Implementing Regulation but retain it in the definition;

b. To amend Article 21 of the MiFID Implementing Regulation to reflect the guidance provided in Recital 15. This amendment is intended to provide further clarity in determining whether business activity has 'material commercial' significance for the firm and for the market.

2.1.2.2 SI obligations

91. The present regime permits SIs to quote one-sided and in a size of only one share – a practice adopted by some but not all SIs. This means that many SIs are publishing quotes that tell the market little about the size of business they are prepared to take on. This information deficiency is accentuated by the fact that it is not possible for market users to assess the volumes and prices of trades conducted by individual SIs. This results from the MiFID Implementing Regulation exempting SIs from revealing their identity[11] in post-trade reports, provided they publish quarterly trading statistics. CESR is of the view that there is a strong case for making SI information more meaningful.

92. Currently, SIs are not allowed to offer price improvement for all orders up to customary retail size (currently set at €7,500) and all retail orders, regardless of size. The rationale for such restriction on price improvement is to provide for equal treatment of retail clients of systematic internalisers and for making quotes displayed meaningful. Whilst the constraints on price improvement were not identified as being problematic in the previous Call for Evidence, CESR also considered whether this particular aspect of the regime needs to be revisited.

93. To address these issues, CESR sought views on some specific amendments to the quoting obligations, restrictions on price improvement and post-trade transparency requirements for SIs.

Feedback and discussion

94. A majority of respondents considered that SI quoting obligations should be made more meaningful, and a number agreed with CESR's proposal to establish a minimum quote size of 10% of standard market size in liquid shares. A majority of respondents also considered that retail participation and best execution could be enhanced by removing the price improvement restrictions for orders up to retail size. However, CESR notes comments that this would make SI quotes less meaningful and would potentially lead to unequal treatment of retail investors.

95. There were divided views on requiring the individual identification of SIs in post-trade transparency reports. Although, some respondents considered that individual identification would level the playing field with RMs/MTFs CESR notes comments that this requirement would significantly impact on firms committing capital/taking risk positions and would increase the costs associated with providing liquidity.

[11] MiFID requires SIs to publish all completed transactions and to identify themselves as the trading venue (e.g. through a BIC) unless they publish quarterly statistical information about their systematic internalisation business (in which case they can publish trades with the generic identifier of 'SI').

Recommendation

96. CESR recommends amending the SI quoting obligations to make them more reflective of and useful to the type of business being undertaken. In particular, CESR recommends that:

    a. SIs be required to maintain two-side quotes;

    b. SIs be required to maintain a minimum quote size equivalent to 10% of the standard market size of any liquid share in which they are a systematic internaliser;

    c. the provision exempting SIs from individually identifying themselves in post-trade reports if they publish quarterly trading data should be retained;

    d. periodic trading data reports for SIs making use of the exemption described in point c be required on a more frequent basis (e.g. monthly).

97. As noted above, CESR also recommends the Commission consider in the broader context of a review of the SI regime whether the price improvement restrictions are still adequate for SIs when dealing with orders up to retail size.

2.2 Post-trade transparency

98. The MiFID post-trade transparency obligations apply to RMs, MTFs and investment firms and are intended to promote the efficiency of the overall price formation process, to assist the operation of the best execution obligation and to mitigate the potential adverse impact of market fragmentation. The information is also used, primarily by buy-side firms, to analyse the cost of transactions and to price portfolios.

99. MiFID broadened the post-trade transparency requirements across Europe most notably by requiring OTC trading to be transparent. However, whilst in some Member States MiFID introduced a higher level of post-trade transparency, in other Member States, as the MiFID deferred publication regime allowed for longer delays than were permissible pre-MiFID, transparency was reduced.

100. In their responses to the Call for Evidence and at CESR roundtables, many market participants expressed concerns about the effect of the fragmentation of post-trade transparency information, especially in relation to OTC trading. In particular, concerns were expressed over the quality of post-trade information, the timing of publication of post-trade information and various barriers to consolidation of post-trade data.

101. As indicated in the June 2009 Report[12], CESR recognises the importance of having trade information of sufficient quality and is concerned about the deterioration which has followed MiFID implementation. CESR also recognises the need for timely post-trade transparency information. CESR's recommendations to improve the quality of transparency information and to reduce delays in the publication of data are outlined in Sections 2.2.1 and 2.2.2 respectively. Recommendations to promote consolidation of transparency information are presented in Section 4 below.

2.2.1 Quality of post-trade information

Background

102. In February 2007, CESR published Level 3 guidelines and recommendations on publication and consolidation of MiFID market transparency data (Ref.: CESR/07-043) in order to facilitate the understanding of MiFID requirements and guard against a potential adverse impact of fragmentation of transparency information post MiFID.

[12] CESR report on 'Impact of MiFID on equity secondary markets functioning', 10 June 2009 (Ref. CESR/09-355), CESR website: http://www.cesr-eu.org/index.php?page=document_details&id=5771&from_id=53.

103. However, many market participants, some of which were subject to an OTC post-trade transparency regime pre-MiFID, have noted that the quality of the transparency data has deteriorated significantly since MiFID was implemented in November 2007. These concerns were particularly pronounced in jurisdictions where all equity transparency information was previously published by the main RM. In those jurisdictions, the main RM not only consolidated equity data but monitored the quality and took appropriate remedial action as necessary.

104. According to market data vendors, investment firms do not always take the necessary steps to ensure that equity trade data is accurate and reliable, leading to a confusing picture of the OTC market. This contrasts with equity data from RMs and MTFs which is generally considered to be of high quality.

The importance of having trade information of sufficient quality is recognised and the deterioration which has followed MiFID implementation is considered to be concerning. CESR also recognises that there is not a single solution to improve the quality of data and that the problems raised reflect different issues, ranging from lack of clarity in the publication obligations to potential deficiencies in firms' compliance with their MiFID obligations.

Feedback and discussion

105. CESR consulted on an approach involving the development of a set of standards to improve the clarity, comparability and reliability of post-trade transparency information and established a CESR/Industry Working Group to work with CESR to finalise these standards. There was near unanimous support from market participants for the overall approach proposed by CESR. Participants agreed that the quality of post-trade information was a vital issue and needed a co-ordinated regulatory and industry approach to ensuring post-trade transparency information was of a high quality.

Recommendation

106. To address the concerns relating to the quality of post-trade transparency information, CESR recommends amending MiFID and the MiFID Implementing Regulation to:

a. embed standards aimed at improving clarity, comparability and reliability of post-trade transparency that would cover matters such as condition codes for trade types and process for correcting erroneous post-trade reports; and

b. provide greater clarity in terms of: i) what constitutes a single transaction for post-trade transparency purposes; and ii) which investment firm shall make information related to an OTC transaction public.

107. CESR also recommends that ESMA be given powers under MiFID to set binding technical standards covering post-trade data quality. This would allow for ESMA to deal with data quality issues as they arise and help to ensure that post-trade data quality can become and remain consistently high.

2.2.2 Timing of publication of post-trade information

2.2.2.1 Real-time publication of transactions not eligible for delay

Background

108. MiFID requires transactions to be published as close to real time as possible, but no later than 3 minutes after the trading time. Indeed, the 3 minute deadline should only be used in

exceptional circumstances where the systems available do not allow for a publication in a shorter period of time. During CESR's Call for Evidence, it was suggested that the quality of post-trade transparency information is negatively impacted because some investment firms routinely use the full 3 minutes to publish a transaction, rather than publishing a trade in real time and using the full 3 minutes on an exceptional basis.

109. CESR notes that in the US there is a requirement to publish information related to 'on exchange' transactions in real time and to publish information related to OTC transactions (which, in the US includes transactions executed on alternative trading systems (ATS) as close to real time as possible but no later than 90 seconds after the trade. The US Financial Industry Regulatory Authority (FINRA) is proposing to reduce the reporting deadline to 30 seconds from the trading time.

Feedback and discussion

110. Respondents were split almost evenly on whether this proposal would be beneficial, with a slight majority in favour of reducing the limit to 1 minute. Those in favour of the proposal believed it would result in improved timeliness of post-trade transparency information while those against the proposal believed that for manually executed or complex trades (such as portfolio trades), particularly during periods of high market volatility, it would be very expensive, if not impossible, for firms to report these trades within 1 minute.

111. CESR strongly believes that clarifying Article 29(2) of the MiFID Implementing Regulation and reducing the time allowed from 3 minutes to 1 minute would improve the transparency of the market, thereby ensuring the price formation process remains fair for all market participants. CESR recognises that, while it may be difficult in certain situations to publish trades within 1 minute and may result in some systems costs, the anticipated benefit of improved transparency should outweigh any costs. CESR believes market participants should have systems and processes in place that allow them to meet the 1 minute deadline even during times of high market volatility, and believes that these are, in fact, the circumstances in which it is most important that post-trade transparency information is timely and accurate. Furthermore, standards and guidelines on the transparency obligations may also facilitate investment firms' timely publication.

Recommendation

112. CESR recommends that in order to improve the timeliness of post-trade transparency information, Article 29(2) of the MiFID Implementing Regulation should be amended as follows:

    a. the obligation which requires RMs, MTFs and investment firms trading OTC to publish post-trade trade information in real time should be strengthened by adding that transactions would need to be published as close to instantaneously as technically possible, and

    b. the deadline for the reporting of these transactions should be reduced from 3 minutes to 1 minute.

113. CESR also notes that systems should not be designed to "batch" the publication of trades so they only get published at fixed intervals, but rather should be published as soon as entered into the system.

2.2.2.2 Deferred publication regime

Background

114. MiFID requires the European Commission to re-examine Table 4 of Annex II of the MiFID Implementing Regulation (deferred publication thresholds and delays). In CESR's Call for

Evidence, market participants were asked whether MiFID categorisation of shares was appropriate for the deferred publication regime and whether the post-trade transparency regime was working effectively.

115. Some market participants are concerned that delays are often too long to ensure adequate transparency and that, in some instances, investment firms seemed to avail themselves of the maximum delay under MiFID even when their positions had already been unwound.

Feedback and Discussion

116. CESR proposed reducing the delays allowed under the deferred publication regime so that the longest delay permitted would be until the end of the trading day. There was a slight majority of respondents in favour of reducing the deadlines as proposed by CESR. Some respondents were concerned however that there would be a reduction in liquidity provision, particularly close to the end of the trading day.

117. CESR believes the overall benefit of improved transparency and reduced information asymmetries across the market outweighs any potential costs. The greatest concern appeared to be over the "end of day" delay for trades executed close to the end of the day, and so CESR recommends extending this deadline to early the following trading day for trades executed late in the day. This will ensure that the vast majority of deferred trades should be reported no later than the end of the trading day on which they are executed, while still providing some protection for trades occurring late in the day.

118. Some respondents also suggested that the definition of the end of the trading day be clarified to ensure that all market participants were aware when trades eligible for deferred publication to the end of the trading day would need to be reported. CESR agrees that it is important for all market participants to be aware what defines the end of the trading day and has made a recommendation to this effect.

Recommendation

119. CESR recommends maintaining the existing deferred publication framework (Table 4 of Annex II of the MiFID Implementing Regulation) which currently encompasses four liquidity bands but to recalibrate delays and thresholds so as to:

    a. shorten the delays to ensure that almost all transactions are published no later than the end of the trading day, with only the very largest trades that occur late in the trading day publishing prior to the opening of trading on the next trading day;

    b. shorten the intra-day delay of 180 minutes to 120 minutes; and

    c. raise all intra-day transaction size thresholds.

    A specific recommendation for deferred publication thresholds and delays are outlined in Table 5 below.

Table 5: Proposed deferred publication thresholds and delays

Class of Shares in terms of average daily turnover (ADT)			
ADT < EUR	**EUR 100 000**	**EUR 1 000 000**	**ADT ≥ EUR**

	100 000	≤ ADT < EUR 1 000 000	≤ ADT < EUR 50 000 000	50 000 000
	Minimum qualifying size of transaction for permitted delay			
60 minutes	EUR 15 000	Greater of 10% of ADT and EUR 30 000	Lower of 15% of ADT and EUR 5 000 000	Lower of 15% of ADT and EUR 10 000 000
120 minutes	EUR 30 000	Greater of 20% of ADT and EUR 80 000	Lower of 25% of ADT and EUR 10 000 000	Lower of 25% of ADT and EUR 20 000 000
Until (a) end of the trading day if trade occurs prior to 15:00; or (b) prior to the opening of trading on the next trading day if trade occurs after 15:00.	EUR 50 000	Greater of 30% of ADT and EUR 120 000	Lower of 35% of ADT and EUR 15 000 000	Lower of 35% of ADT and EUR 35 000 000

120. CESR recommends clarifying that the opening and end of the trading day with regards to deferred publication be defined as follows:

a. For a transaction eligible for deferred publication executed on an RM or MTF, the opening and end of the trading day refers to the start and end of the normal trading hours of the RM or MTF on which the transactions was executed. In any case, this should not be earlier than 8.00 and later than 17.30 in the time zone of that RM or MTF.

b. For a transaction eligible for deferred publication executed outside an RM or MTF, the opening and end of the trading day refers to 08:00 and 17:30 (respectively) in the time zone of the most relevant market in terms of liquidity for that share, as defined in Article 9 of the MiFID Implementing Regulation.

Similarly, CESR recommends that, for a transaction eligible for deferred publication executed on an RM or MTF, references to 15:00 in Table 5 should relate to the time zone of the given RM or MTF. For a transaction eligible for deferred publication executed outside an RM or MTF, references to 15:00 should relate to the time zone of the most relevant market in terms of liquidity for that share.

3. Application of transparency obligations for equity-like instruments

Background

121. It has been proposed by some market participants and competent authorities that certain equity-like instruments admitted to trading on a RM should be subject to the same transparency requirements as shares under MiFID. At present, some Member States have applied MiFID transparency obligations to depositary receipts (DRs) whilst others have not. When traded on organised trading platforms, DRs are typically subject to the trading platforms' rules governing transparency and, in many cases, trading platforms have implemented the same transparency obligations which apply to shares admitted to trading. Likewise, exchange traded funds (ETFs) and 'certificates' which are admitted to trading on RMs are typically subject to the same transparency regime as shares[13].

122. CESR has considered whether such 'equity-like' instruments should be subject to pan-European mandatory transparency obligations (i.e. pre and post-trade). In considering this question, CESR has decided not to focus on legal interpretation issues, recognising that because of specific legal characteristics, an instrument might fall within the MiFID definition of shares in one jurisdiction but not in another one ('certificates' being a case in point). Rather, CESR considered whether these instruments were, from an economic point of view, equivalent to shares and whether there would be benefits stemming from a harmonised pan-European transparency regime.

123. For instance, whilst the Net Asset Value (NAV) of a given ETF is often calculated at the end of the trading day using the closing price of the underlying securities and, in some cases, intraday NAV (iNAV) is also available, investors will typically not buy and sell ETFs at their NAV or iNAV on the secondary market. This is because the price of an ETF on organised trading platforms or OTC is affected by supply and demand forces. CESR considers that additional transparency might help investors make timely and informed investment decisions when buying/selling ETFs.

Feedback and discussion

124. In general there is broad support for the application of transparency requirements to the above mentioned equity-like securities. However, market participants expressed their desire to have a fully harmonised and properly calibrated regime with clear definitions which also takes into account the time necessary to implement these new requirements, potentially in the form of a gradual approach. There is broad agreement to use the same MiFID equity transparency calibration regime as for equities under MiFID.

125. Although proposed in the consultation paper, after further consideration, CESR does not think that it would be appropriate to extent the transparency regime for shares to all ETCs as some ETCs have significantly different characteristics to shares. However, where an ETC takes the form of an ETF it would be covered by the proposed extension of the transparency regime.

126. CESR believes that the instruments defined below share many characteristics with shares, including liquidity, structure, transparency of underlying instruments and types of investors. CESR therefore believes it would be beneficial to the market to require these kinds of instruments to meet the same transparency requirements as shares. CESR does however recognise the importance of ensuring that only appropriate instruments are covered by these requirements and have set out the features of the instruments that would be appropriately covered by these transparency requirements.

Recommendation

[13] Some RMs have implemented a publication service for transactions in ETFs executed OTC. In a separate initiative, some investment firms have voluntarily began to publish post-trade transparency information when trading ETFs OTC.

127. CESR recommends applying the MiFID transparency regime for the following equity-like financial instruments admitted to trading on an RM:

a. DRs (whether or not the underlying financial instrument is an EEA share)[14];

b. ETFs (whether or not the underlying is an EEA share, a fixed income instrument or a commodity)[15]; and

c. 'Certificates'[16].

In practice, this would mean that the MiFID transparency obligations would apply whether the instrument is traded on RM, MTF or OTC[17].

128. The following is a general outline of each type of financial instrument listed above. This does not however constitute legal definitions of the securities.

a. Depositary receipts - DRs are negotiable certificates that represent ownership of a given number of a company's shares and can be listed and traded independently from the underlying securities. DRs are typically traded in US dollars or local currencies and issued by a depositary bank. Several forms of DRs can be listed and traded on EU RMs, including Global Depositary Receipts (GDRs) and American Depositary Receipts (ADRs).

b. Exchange-traded Funds - ETFs are open-ended collective investment schemes admitted to trading on an RM. ETFs attempt to replicate an index (or other defined set of assets) and therefore provides investors with an economic exposure to the assets. ETF issuers provide a process for the issuance and redemption of units in the fund. ETF investors, other than authorised participants, transact in the units of an ETF through purchases and sales on the secondary market rather than through subscriptions and redemptions in the primary market. Market makers provide ongoing liquidity in ETFs on organised trading platforms and OTC. A list of the underlying assets held by the ETF and their Net Asset Value are usually published daily to the market. Trading value is usually close to net asset value, with any tracking error being the result of trading and rebalancing costs associated with holding the underlying index constituents optimising portfolio. ETFs may be physical (where the fund invests directly in the underlying assets that compose the portfolio) or synthetic (where the ETF gains exposure to the index by entering into a swap agreement with a swap counterparty).

c. Certificates - These are securities issued by a company that 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 transparency regime. CESR is aware of a possible broader understanding of this term but wants to make clear that, for the purposes of its review, the above narrow definition is considered appropriate.

129. CESR would emphasise that transparency obligations should only apply to the secondary trading of ETF and not to primary market transactions (as explicitly excluded from MiFID under Article 5(c) of the MiFID Regulation.

130. CESR recommends that the Commission undertake additional work to determine the appropriate thresholds for application of the pre-trade large-in-scale and post-trade deferred

[14] See definition in paragraph 129a below.
[15] See definition in paragraph 129b below.
[16] See definition in paragraph 129c below.
[17] In the case of DRs this may include distinctions depending upon whether the underlying financial instrument is an EEA share for the purpose of the market transparency calculations.

publication regimes. However, prima facie, CESR believes that, given the equity-like instruments trade like equities and on the same platforms, the existing calibration regime for shares is likely to be appropriate for equity-like instruments,

4. Consolidation of transparency information

131. Prior to the implementation of MiFID, in the vast majority of Member States, trading in shares was concentrated on an RM. Alternatively, where trading was permissible away from an RM's system, it was typically reported to an RM (though this was not required in some Member States). These arrangements had the effect of concentrating trade information for each share in one, or a few, places providing market participants with a consolidated view of trading in a particular share. MiFID, on the other hand, has fostered the rise of new trading venues and introduced competition in trade publication services by giving investment firms, when trading as SIs or OTC, choice in where they publish their transparency information. As a result, data can now be available from a number of different sources, depending on where it is published. Fragmentation of transparency information, if not addressed properly, raises concerns because it could undermine the overarching transparency objective in MiFID, and may result in less transparent markets than was the case pre-MiFID. In order to achieve efficient price discovery and facilitate the achievement, and monitoring, of best execution, trade information published through different sources needs to be reliable and brought together in a way that allows for comparison between the prices prevailing on different trading venues.

132. With the implementation of MiFID there was an expectation that market forces would provide market participants with a way of accessing a consolidated set of data and a number of initiatives have been put in place with this aim. Since MiFID implementation many data vendors have been delivering consolidated data. However these services are not of a standard that fully satisfies market participants. Market participants believe that whilst some concerns exist in relation to the fragmentation of pre-trade information, regulators should focus first on barriers to consolidation of post-trade transparency information.

133. CESR is of the view that regulatory intervention (in addition to addressing issues surrounding the quality of transparency information) is necessary in order to facilitate consolidation. CESR agrees that the focus should be on post-trade transparency information as a priority.

4.1 Regulatory framework for consolidation

Background

134. A recurring theme in the analysis of why consolidated data is not being delivered to the market to the standard it needs is the inadequate quality and consistency of the raw data itself, the inconsistencies in the way in which firms report it for publication, and the lack of any formal requirements to publish data through bodies with responsibilities for monitoring the publication processes.

135. CESR and market participants generally agree there is a need for an affordable consolidation of post-trade information but there are different views about how best to achieve it. Below are CESR recommendations to ensure the quick development of a European consolidated tape for transparency information at a reasonable cost.

4.1.1 Multiple approved publication arrangements

136. The first recommendation for improving the quality of data consolidation sets out to supplement the introduction of new standards to improve data quality and achieve greater consistency in trade publication practices (as outlined in Section 2.2.1) by requiring investment firms to publish their trade reports through Approved Publication Arrangements (APAs). Under this proposal, competent authorities would approve entities wishing to act as an APA, and APAs would be required to operate data publication arrangements to prescribed

standards. More details are set out below, addressing the standards that would be set for APAs and the adequacy of the present provisions for requiring publication arrangements to facilitate consolidation.

Requirements for investment firms

137. Investment firms that execute transactions in shares[18] OTC would be required to make public the post-trade transparency information using an Approved Publication Arrangement (APA). An APA could be:

   a. an RM;

   b. an MTF; or

   c. another organisation.

138. Investment firms should be allowed to use any APA in the EEA and may, if they wish, use more than one APA, although they would need to ensure that each transaction is not published more than once by a primary publication arrangement. As is currently the case, investment firms would be responsible for ensuring that post-trade data provided to an APA is reliable and monitored continuously for errors.

Requirements for APAs

139. An APA would need to be approved by its competent authority. Before approving an APA, competent authorities would need to ensure that the applicant met stringent criteria. Proposals for these criteria are set out in Annex I.

140. In addition to having to demonstrate that they meet these requirements at the time of approval, APAs would be subject to ongoing monitoring by the competent authority in respect of continuing compliance. The competent authority would also ensure that the APAs were undertaking appropriate checks to ensure they were publishing data with all relevant fields appropriately completed and accurate, and that the error-checking mechanisms each APA had in place were appropriate.

141. APAs would be required to provide access to post-trade information submitted by an investment firm upon request by the firm's competent authority. To meet this obligation, APAs would need to maintain post-trade information for 5 years after the APA has disseminated the post-trade transparency information to the public.

142. In addition, APAs would be required to provide ad hoc and periodic information to an investment firm's competent authority relating to the quality of data provided by the investment firm.

143. It is also proposed that CESR/ESMA maintain and publish a list of APAs. APAs would be required to provide CESR/ESMA a list of investment firms using their facilities to publish trade reports and keep it up to date. This information would be available only for CESR members.

Feedback

144. There was almost unanimous support for the proposed APA regime. Most respondents believe it would help to improve the quality of post-trade transparency information and prevent the reporting of trades in unusual locations (i.e. in locations not usually used by the investment firm) or in formats that prevent the consolidation of post-trade transparency information across Europe. Respondents were however split on whether the proposal would in fact result in the development of a European consolidated tape.

[18] Including shares admitted to trading on an RM as well as 'equity-like' instruments as per Section 3.

Recommendation

145. CESR recommends implementing the APA regime and the framework and standards provided in Annex I.

4.1.2 Cost of market data

Background

146. MiFID currently requires that transparency information be made available to the public on a non-discriminatory basis at reasonable cost. Some European data vendors have recently cut their data prices significantly. However, concerns remain that the cost of real-time market data is restricting the availability of affordable consolidated European post-trade data. Market data providers have estimated that a total fee for a full data set of pre- and post trade data of all EU venues would cost about € 450 per user per month. In comparison, the cost of consolidated post-trade data in the US is US$ 70 (around €50) per user per month. CESR recognises that there are significant differences between the European and US market data regime (e.g. competitive model in Europe compared to a monopoly in the US, a much higher number of trading venues and shares traded in Europe).

147. CESR made two proposals in its consultation paper. The first was to prevent platforms and APAs from requiring market participants to purchase both pre-trade and post-trade transparency information. The second was to require all platforms and APAs to provide their post-trade transparency information to market participants for free 15 minutes after the initial reporting of the trade.

Feedback and discussion

148. A majority of respondents believed unbundling pre-trade and post-trade transparency information would reduce the cost of post-trade transparency information. However a number of respondents did not believe it would reduce the cost, or believed that, without appropriate controls in place, the combined cost of pre- and post-trade data might increase if this proposal was implemented. Most venues (RMs, MTFs and APAs for OTC data) already provide post-trade transparency information for free 15 minutes after publication. There was majority support from respondents for implementing this proposal.

149. CESR believes these proposals are likely to reduce the cost of market data. The proposal to unbundle pre-trade and post-trade data would be likely to improve the competitiveness of the market for data by ensuring that market participants could choose whether to purchase pre-trade data or post-trade data, while platforms could still offer a package including both. CESR also believes that the proposal to require data to be provided for free after 15 minutes would ensure a consolidated tape of post-trade transparency information could be produced for free on a 15 minute delay basis.

Recommendation

150. CESR recommends that the Commission require the unbundling of pre-trade and post-trade transparency information. CESR also recommends that all post-trade transparency information must be made available free of charge after a delay of no more than 15 minutes.

151. CESR believes it must be made clear under MiFID that any third-party used to re-sell or disseminate data (such as data vendors or APAs) should meet the requirements set out above. This means that RMs, MTFs and APAs would need to ensure that data vendors unbundle pre-

trade and post-trade transparency information provided by each organisation. CESR also notes that the requirement for organisations to provide post-trade transparency information for free would not require them to provide the data initially and then separately 15 minutes later. Rather these organisations could achieve the latter by ensuring an organisation that disseminates the information does so for free 15 minutes after initial publication.

4.1.4 MiFID transparency calculations

Background

152. For the purposes of MiFID transparency calculations for each stock, competent authorities currently use data provided by the primary RM trading each stock (and in some instances, MTFs). In order to ensure the continued accuracy of these calculations, each competent authority should use all post-trade transparency data for each stock, including information from RMs, MTFs and OTC reporting arrangements (e.g. APAs under the approach for consolidation proposed above). In order to do this, each RM, MTF and OTC reporting arrangement would be required to provide data to the relevant competent authority for this purpose.

Feedback

153. There was virtually unanimous support for this proposal when it was put forward in the Consultation Paper and it is considered a sensible improvement upon the current regime.

Recommendation

154. CESR recommends requiring each RM, MTF and OTC reporting arrangement to provide data free of charge to the relevant competent authority and, where appropriate, ESMA for the purpose of MiFID transparency calculations.

4.1.3 EU mandatory consolidated tape

Background

155. CESR noted in the Consultation Paper that the proposals to improve data quality could be supplemented by the development of a mandatory consolidated tape that would provide comprehensive consolidation and offer market users a single point of access to post trade information. CESR outlined in the Consultation Paper the key characteristics of such a consolidated tape, covering the data it provided, its operation, fees/charges, etc, and posed a broad range of general and specific questions.

Feedback and discussion

156. A majority of respondents to CESR's Consultation Paper did not believe it was necessary to introduce a consolidated tape led by the authorities/regulators until the other proposals in the Consultation Paper (such as those regarding APAs and the cost of market data) had been implemented and it was seen whether they were sufficient to facilitate the development of an industry-led consolidated tape. A minority of respondents believed that the aim of an industry-led European consolidated tape could not be achieved and so a consolidated tape led by the authorities was now necessary. A small number of respondents believed as a matter of principle that an authority-led consolidated tape should not be developed.

Recommendation

157. CESR strongly believes that it is necessary to develop a consolidated tape of European post-trade transparency information. CESR does not believe that this currently exists in a form that is at a reasonable price or useful for the vast majority of market participants.

158. CESR is of the view that an obligation to establish a European consolidated tape as well as the rules for and the main features of the tape need to be outlined in MiFID. The European consolidated tape should have at least the following features:

a. For all shares admitted to trading on an EEA RM, a European consolidated tape must provide post-trade transparency information for all transactions taking place on an EEA RM, MTF or through an investment firm as an OTC transaction (as required by MiFID), irrespective of where within the EEA the trade was executed.

b. To ensure a high quality of data, all information on the consolidated tape must come from either an RM, MTF or APA (i.e. it cannot come directly from investment firms).

c. It must disseminate information that is provided by each RM, MTF or APA in real-time and in as low latency a form as is reasonably possible.

d. The operator of the consolidated tape must receive post-trade data from RMs, MTFs and APAs on an unbundled basis (i.e. separate from pre-trade data, as discussed above).

e. The consolidated tape must be offered to users on a share-by-share basis so they have the option of purchasing transparency information about only those shares in which they have an interest. This would not prevent the operator of the consolidated tape from also offering packages of shares (such as share indices). Similarly, users should be free to purchase transparency information without having to buy any value-added products.

f. The consolidated tape must be available to all market participants in a format that is conducive to data analysis, including execution quality or transaction cost analysis.

g. The consolidated tape must be easily accessible to markets and investors and be available at a reasonable cost. A reasonable cost may differ depending on the user of the data (e.g. an individual user may be charged a different sum to an investment firm), although the cost must be the same for all participants within the same class of user.

h. The consolidated tape would need to meet certain standards covering but not limited to security, dissemination (i.e. publication of information), operating hours, resources, operational reliability, contact arrangements, transparency of charges, conflicts of interest, outsourcing and monitoring. The operator of the consolidated tape would be responsible for the detection of possible multiple publication (same transaction being sent to more than one primary source).

i. The operator of the consolidated tape would need to keep the published data available for at least a period of 5 years to assist in the MiFID transparency calculations. The operator of the consolidated tape would need to provide access to trade reports to the competent authority for the share in question for a period of 5 years after the reporting of the trade. The operator of the consolidated tape would need to make its services available to any person wishing to subscribe to its data.

159. Regarding the technical realisation of the European consolidated tape, CESR recommends to implement the tape on the basis of a project developed by the industry. This approach would leverage the anticipated benefits expected from the introduction of the APA regime and the requirements for the unbundling of trade data. It places the emphasis on the users, creators and disseminators of transparency data to design a solution that best meets their collective needs (including the necessary IT infrastructure and data formats) and gives the industry scope to determine a fair allocation of costs and charges associated with delivery of the solution.

160. Having legally mandated the establishment and the essential features of a European consolidated tape through an amendment of MiFID, there should be a clear and relatively

short timetable for the industry to deliver the consolidated tape. ESMA should have the power and mechanisms to launch the process through which the European consolidated tape is built by the industry with appropriate interim milestones, and to monitor progress, implementation and operation of the consolidated tape thereafter. As part of this role, ESMA should also be allowed to intervene with respect to prices charged for market data.

161. The Commission and ESMA should be responsible for eventually determining if at least one European consolidated tape containing the features outlined in MiFID had been achieved. In case of default at any point in the process (including a failure to achieve a firm commitment of the industry), MiFID should identify a clear course of action and require the establishment of a mandatory single European consolidated tape run as a not-for-profit entity on the basis of terms of reference and governance to be set out by ESMA.

5. Regulatory boundaries and requirements

5.1 Regulated markets vs. MTFs

Background

162. In response to the CESR Call for Evidence, RMs expressed concerns that they are faced with an unlevel playing field vis-à-vis MTFs. While the MiFID provisions governing RMs and MTFs are to a large extent similar, RMs are concerned that they are subject to more stringent – and costly – regulatory requirements than their MTF competitors. For example, MiFID allows different capital requirements for RMs and investment firms operating MTFs. Rules relating to admission to trading of financial instruments and the verification of issuer disclosure obligations apply only to RMs and, unlike MTFs, RMs wishing to trade an issuer's shares admitted to trading on another RM can do so only 18 months after the original admission and may do so only following publication of a summary note of the issuer's prospectus. In some Member States additional requirements on RMs that go beyond MiFID have been implemented. Whether these or other differences create an unlevel playing field was not specifically mentioned in the responses to CESR.

163. However, a key difference between requirements for RMs and MTFs operated by investment firms, which may be a potential source of unlevel playing field is the concept of "proportionate approach[19]" for organisational requirements that apply to MTFs and the discretion that may be attached to such test of "proportionality" by competent authorities. In this regard, an extension of requirements for RM under Article 39(a) to (c) of MiFID to investment firms or market operators operating an MTF may provide more clarity that RM and MTFs should be subject to the same organisational requirements as regards the operation of their trading platform.

164. CESR sought views on proposals to provide a greater alignment of RM and MTF requirements.

Feedback and discussion

165. A number of respondents supported the CESR proposals to align certain requirements for RMs and MTFs. While it was accepted that the proposals may impose some additional costs, these were thought to be outweighed by resultant benefits. It was also noted that costs would be minimal where existing MTFs already comply with similar requirements. Others considered that the existing MiFID provisions were sufficient, or that further work was necessary to

[19] 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.

determine the impact of these proposals. Some suggestions included possible exemptions for 'junior markets' or a threshold beyond which an MTF would have to become an RM.

Recommendation

166. In addition to the requirements set out in Article 13 of MiFID, CESR recommends that investments firms operating an MTF should:

a. have arrangements to identify clearly and manage the potential adverse consequences for the operation of the MTF or for its participants, of any conflict of interest between the interest of the MTF, its owners or its operator and the sound functioning of the MTF, and in particular where such conflict of interest might prove prejudicial to the accomplishment of any functions delegated to the MTF by the competent authority;

b. be adequately equipped to manage the risks to which it is exposed, to implement appropriate arrangements and systems to identify all significant risks to its operation and to put in place effective measures to mitigate this risks;

c. to have arrangements for the sound management of the technical operations of the system, including the establishment of effective contingency arrangements to cope with risks of systems disruptions.

5.2 Investment firms operating internal crossing systems/processes

Background

167. A number of investment firms in the EU operate systems that match client order flow internally. Generally, these firms receive orders electronically, utilise algorithms to determine how they should best be executed (given a client's objectives) and then pass the business through an internal system that will attempt to find matches. Normally, algorithms slice larger 'parent' orders into smaller 'child' orders before they are sent for matching. Some systems match only client orders, while others (depending on client instructions/ permissions) also provide matching between client orders and 'house' orders.

168. Investment firms operating these systems are subject to client-oriented conduct of business rules, including best execution, rather than the market-oriented rules designed for RMs and MTFs. They are required to provide post-trade transparency for OTC transactions in shares admitted to trading on an RM. Investment firms are also required to have arrangements in place for identifying conflicts of interest and to notify competent authorities when they suspect a transaction might constitute insider dealing or market manipulation.

169. There has been considerable debate over the past year about the nature and scale of business executed by broker dealers in their internal crossing systems/processes and the way it is regulated. It has been suggested that use of these systems is significant and that they have been increasing their share of trading, in part because the systems are not subject to the same levels of transparency as are required of RM and MTF systems.

170. To establish a factual context for considering these issues, CESR conducted a fact finding towards the end of 2009[20]. In total, 11 investment firms from four different jurisdictions provided data, though the data from several firms whose systems became operational during the period covers only the latter parts of the period

171. The data supplied indicates that the proportion of total EEA trading executed by large investment firms in these systems is very low, ranging from an average of 0.7% in 2008 to an average of 1.15% in 2009 (increasing to 1.5% in the first quarter of 2010) (see Table 6 below).

[20] For purposes of the fact finding, broker operated crossing systems/processes were defined as internal electronic matching systems operated by an investment firm that execute client orders against other client orders or house account orders. Information related to internal electronic systems used exclusively for systematic internalisation was excluded and only trades executed in crossing systems/processes where post-trade transparency information is published are included (i.e. internal transactions where a house account order matches against another house account order are excluded).

Table 6: Trading executed in brokers' crossing processes/networks[21]

	2008				2009				2010
	Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**
Value (in bn euros)	37.7	39.7	43.4	39.9	28.0	36.9	47.7	55.7	58.9
Crossing as a % of OTC Trading	1.5	1.2	2.0	3.0	2.4	2.1	4.4	4.0	4.4
Crossing as a % or total EEA trading	0.6	0.6		0.7	0.9	0.9	0.9	1.4	1.5

Sources: (1) Value of trading executed on brokers' crossing systems/processes: information collected from 11 European investment firms and aggregated by competent authorities; (2) Total value of OTC trading in EEA shares: Thomson Reuters; (3) Total trading in EEA shares: Thomson Reuters

172. Investment firms consider that internal matching of client orders, whether manual or automated, is core to traditional brokerage activity. They view it as being only one of a range of means that they use to execute client business and as providing execution efficiency.

173. Some CESR members consider that the current legal framework does not support a requirement for investment firms to register their internal crossing networks as MTFs. In particular, these systems do not have participants in the way that a standalone MTF does. In some jurisdictions, some investment firms operating internal crossing systems have decided to operate an MTF but are having to modify their business models significantly to bring the new activity within the MTF definition.

174. CESR put forward proposals to introduce bespoke requirements for firms operating internal crossing systems and to impose a limit on the amount of client business that could be executed in a broker crossing system (BCS) before it would be required to become an MTF.

Feedback and discussion

175. There were divided views on CESR's proposed definition of a BCS. Some respondents were comfortable with the definition. Others considered that the definition was too broad, or that internal crossing systems should be regulated within the existing MiFID regimes for MTFs and systematic internalisers.

[21] It should be noted that the value of OTC trading published by Thomson Reuters and used here, and as a consequence the value of EEA trading published by Thomson Reuters, may be inflated due to multiple reporting of a single transaction.

176. A number of respondents supported the bespoke requirements for BCS. They considered these would provide greater clarity on the regulatory requirements. Other respondents questioned whether additional requirements were necessary given the relatively small volume of business done in internal crossing systems. A number of respondents (both institutional investors and sell-side firms) expressed concerns about a requirement to identify BCS (individually using their BIC) real-time in post-trade transparency reports. Some considered that current transparency requirements were sufficient. They believed this proposal would subject clients to unnecessary market impact and has the potential to damage liquidity provision. As an alternative, a generic BCS identification was suggested with end of day reporting of BCS trades. In this context, respondents noted the voluntary industry initiative by a number of investment firms for end of day reporting[22].

177. There were divergent views on the proposal to place a limit/threshold on BCS business before it would be required to become an MTF. Those in favour of the proposal considered a threshold should be based on total European trading and that further work should be done to clarify the nature of OTC trading. Those against the proposal noted that internal crossing systems are client-oriented, discretionary models which are fundamentally different to the business of an MTF. This proposal would require a change in business structure, creating significant operational implications and additional costs. Respondents suggested that further analysis was needed to determine whether it was appropriate to place a limit on BCS business. They considered this approach may not be effective in delivering regulatory objectives (e.g. greater transparency). Others noted the importance of assessing the cost/impact of the proposal.

Recommendation

178. CESR recommends that a new regulatory regime be created for investment firms operating broker crossing systems (BCS), CESR considers a BCS to be an internal electronic matching system operated by an investment firm that executes client orders against other client orders or, occasionally, house account orders on a discretionary basis.

179. Investment firms operating a BCS would be subject to the following:

a. A requirement for investment firms operating such systems to notify their competent authority and provide a description of the system, including (at least) details on access to the system, the orders that may be matched in the system, the trading methodology, the arrangements for post-trade processing and trade publication;

b. A requirement for competent authorities to place on the CESR/ESMA website the name of any firm that has notified it that it operates a broker internal crossing system with the respective BIC code to identify the crossing system;

c. A requirement for investment firms to add a generic BCS identifier for its crossing system to their post-trade transparency information for all transactions executed on such systems. Investment firms would be required to make public aggregated information at the end of each day, including the number, value and volume of all transactions executed in their internal crossing system;

d. A requirement that investment firms identify in their transaction reports to competent authorities whether the transaction was executed in a BCS and, if so, which BCS was used;

e. In addition, investment firms that operate a BCS would be brought within the scope of the MiFID Article 41(2). This would require a competent authority demanding the

[22] Markit BCS shows the volume of European cash equities executed in Broker Crossing Systems (BCS); including Citigroup; Credit Suisse; Deutsche Bank; JP Morgan; Morgan Stanley; and UBS. For these purposes, the Markit Boat website defines a Broker Crossing System as an internal automated process operated by a broker-dealer that matches buy and sell orders on a discretionary intra-spread basis within a pricing methodology referencing an appropriate BBO. Markit BCS data is a subset of total volume reported across all publication venues as 'OTC' and 'SI' and is presented in aggregate form at a country level. Markit Boat website: http://www.markit.com/en/products/data/boat/boat-bcs-reports.page?

suspension or removal of a financial instrument from trading on an RM or MTF to make a similar demand to a BCS; and

f. CESR notes that an investment firm operating a BCS would also be required to satisfy organisational requirements set out in Article 13 of MiFID, including taking all reasonable steps to prevent conflicts of interest through the operation of organisational and administrative arrangements; and to ensure continuity and regularity of performance of investment services/activities through appropriate and proportionate systems, resources and procedures;

180. CESR also recommends the Commission impose a limit on the amount of client business that can be executed by investment firms' crossing processes/networks before the crossing system is required to become an MTF. This implies that, for instance, obligations such as pre-trade transparency and fair access would be applicable once internal crossing processes reached a certain percentage of the market (i.e. similar to the proposed US approach), either on its own or in combination with other crossing systems/processes with which they have a private link. CESR stands ready to assist the Commission in determining what an appropriate limit would be.

6. MiFID options and discretions

181. CESR undertook an internal mapping exercise of discretions within MiFID in order to identify areas where a more harmonised approach might be desirable. Regarding some options and discretions which are related to the work on the MiFID Review on equity markets, CESR therefore wished to take the opportunity to ask for the views of market participants on certain options and whether to turn certain discretions into rules. A few other options and discretions granted to competent authorities in the MiFID provisions might rather be addressed by further harmonisation of supervisory practices within the regular CESR Level 3 work if considered appropriate after internal discussion among CESR members[23].

6.1 Waiver of pre-trade transparency obligations

Background

182. Articles 29(2) and 44(2) of MiFID and Articles 18 to 20 of the MiFID Implementing Regulation foresee discretion for Competent Authorities to waive the obligation for RMs and MTFs to provide for pre-trade transparency under Article 29(1) and 44(1) of MiFID based on market models or the type and size of orders.

183. Some of the waivers such as the order management facility waiver for Iceberg and stop orders in Article 18(2) of the MiFID Implementing Regulation are used in a wide variety of Members States while others, e.g. the reference price waiver, are used in a more limited number of countries. This does not necessarily point at a divergent application of the waiver but rather results from the fact that the business models of RMs and MTFs in the Member States vary. Furthermore, the practice of granting waivers varies in Member States. While in most jurisdictions the waiver provisions in MiFID have been implemented in a way that requires approval of individual arrangements, either by individual decision or by approval of (amendments to) the rules of an RM or MTF, in other Member States there is no such requirement.

Feedback

184. Feedback from respondents to the CP generally indicated a preference for all Competent Authorities automatically to allow use of the pre-trade transparency waivers.

[23] This covers the following discretions of competent authorities: to waive the obligation to make public limit orders that are large in scale compared with normal market size in Article 22(2), to authorise RMs and MTFs to defer publication of details of transactions based on their type or size in Articles 30(2) and 45(2) of MiFID and Article 28 of the MiFID Implementing Regulation,

Recommendation

185. Despite the feedback from respondents, CESR considers it appropriate to retain the existing discretion regarding the use of the pre-trade transparency waivers and to retain a role for CESR/ESMA in considering the use of the waivers to ensure their consistent and reasonable use.

6.2 Determination of liquid shares

Background

186. 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 an RM 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.

187. 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.

188. CESR consulted on whether a deletion of this discretion was desirable and, if it were, whether the future harmonised criteria for the definition of a liquid share should cover both (a) and (b) or only one of the two criteria.

Feedback

189. Generally, respondents to the CP wanted a single, harmonised approach to the determination of liquid shares and wanted this to incorporate both point (a) and point (b) above.

Recommendation

190. Competent Authorities have employed differing approaches hitherto to determining which shares should be considered liquid, and this seems to have operated without significant difficulty. The 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. Given these two points, CESR would recommend that the existing discretion be retained.

6.3 Immediate publication of a client limit order

Background

191. The order handling rules under Article 22(2) of MiFID prescribe that investment firms have to take measures to facilitate the earliest possible execution of a client limit order in respect of shares admitted to trading on an RM, when the order is not immediately executed under prevailing market conditions. The firm is required to make public immediately that client limit order in a manner which is easily accessible to other market participants, unless the client expressly instructs otherwise.

192. MiFID creates discretion for Member States to decide that investment firms comply with this obligation by transmitting the client limit order to an RM and/or an MTF.

193. The vast majority of CESR members apply this discretion. In practice, clients also often expressly instruct their investment firms not to disclose the limit order immediately to the public as foreseen in MiFID. CESR therefore consulted on replacing the discretion with a rule under Article 22(2). This rule would allow investment firms to comply with the obligation to

make the client limit order immediately public in an easily accessible manner by transmitting the client limit order to an RM and/or MTF.

Feedback

194. Respondents to the CP wanted the discretion to be embedded in MiFID as a rule and for clients to continue to be able to instruct their investment firms not to disclose unexecuted limit orders.

Recommendation

195. CESR recommends that the Commission embeds the discretion discussed above as a rule in MiFID. However, this should not impact on the option of clients to instruct their investment firms not to display their unexecuted limit orders.

6.4 Requirements for admission of units in a collective investment undertaking to trading on an RM

Background

196. Article 36(2) of the MiFID Implementing Regulation grants discretion to Member States to provide that it is not a necessary precondition of the admission of units in collective investment undertakings to trading on an RM that the RM satisfy itself that the collective investment undertaking complies or has complied with registration, notification or other procedures which are a necessary preconditions for the marketing of collective investment undertakings in the jurisdiction of the RM.

197. CESR consulted on whether this option should be retained since only few Member States have made use of this discretion to date. CESR members from those Member States considered that the admission of units in collective investment undertakings to trading on an RM in a Member State and the marketing of a collective investment undertaking in that Member State were two separate and distinct activities. They also believed that marketing of units of collective investment undertakings to domestic investors was adequately controlled by other investment fund and intermediary legislation, and that there was no evidence that operation of the discretion had raised any concerns.

Feedback

198. A majority of respondents to the CP indicated that they wanted the existing discretion to be retained.

Recommendation

199. Given the above, CESR recommends that the existing discretion provided to Competent Authorities in MiFID be retained.

7. Micro-structural issues in European secondary markets

7.1 Summary of the responses to the Call for Evidence on European micro-structural issues

200. In April 2010, CESR issued a Call for Evidence on micro-structural issues in the European equity markets. The key themes emerging from the responses received to the Call for Evidence and the next steps CESR proposes are outlined below.

7.1.1 High frequency trading

Defining high frequency trading

201. Respondents to CESR's Call for Evidence on micro-structural issues defined high frequency trading (HFT) in various ways. Rapid, automated execution of trading strategies was one key theme (e.g. high velocity order entry), with HFT firms being highly sensitive to latency and regular users of co-location services. Many, although not all respondents suggested that HFT activity was characterised as being market-neutral, with positions closed out by the end of the day. Some noted that this type of trading was proprietary in nature. Importantly, though, no single, agreed definition of HFT emerged and estimates of its significance in the markets (provided mainly by trading platforms) varied from 13% to 40% of total trading

Drivers and growth of HFT

202. The drivers of HFT were considered to be numerous: the availability of specialist programming/IT staff; profit opportunities from arbitrage across new venues and asset classes; reduced frictional costs; increased volumes and volatility due to macro events; and standardised minimum tick sizes across venues for each security. The limitations on HFT were considered to be: tick sizes forcing order book queuing; decreased volumes and volatility due to macro events; increased HFT competition reducing profits; costs of trading (including investing to reduce latency further), clearing and settlement; regulatory restraint/taxes; and the cost of connecting to multiple venues and managing order flow between them.

203. Some respondents felt HFT would continue to grow as costs fell and the adoption of sophisticated trading strategies and technology increased. Others felt that HFT was driven by arbitrage opportunities and would rapidly reach a natural limit, especially if venue consolidation started to occur.

Impacts of HFT

204. The majority of respondents argued that HFT firms had played a role in supplying the markets with liquidity. This had helped to reduced bid-offer spreads and had reduced demand and supply imbalances, thereby helping to limit volatility. Others argued that HFT firms had benefitted the markets by eliminating arbitrage opportunities and aligning prices across markets. However, others questioned whether HFT firms had encouraged volatility in order to benefit from market movements and noted that they had the option to withdraw their liquidity at any time.

205. The risks posed by HFT firms that were put forward by respondents included (inter alia): systemic risks through increased bandwidth usage, order entry/deletion and rogue algorithms; increased market abuse, with detection becoming more difficult in a fragmented and highly automated environment; sudden liquidity withdrawal; and potential de-correlation of prices from market fundamentals if trading strategies focussed solely on short term profits.

Regulating HFT

206. The majority of respondents felt HFT-specific regulations were not required. Some respondents noted that it was important for trading venues' systems to keep pace (e.g. trading capacity and monitoring capabilities) and that additional market surveillance was needed to combat possible market abuse. However, others felt that all HFT firms should be caught by MiFID's provisions or that they should at least be required to meet capital requirements.

7.1.2 Sponsored access

207. Respondents to the Call for Evidence noted that sponsored access arrangements increased trading volumes and liquidity and allowed users to reduce latency and control their executions. Concerns about sponsored access revolved around the risk of erroneous activity, the possible impact on the integrity and orderly functioning of markets, and the risks to sponsoring firms. There was strong support for consistent pre-trade risk management and controls for both sponsoring firms and venues that allowed sponsored access flow.

7.1.3 Co-location

208. Responses to the Call for Evidence reflected the value of co-location in reducing latency and noted that this increased trading activity and liquidity. It was also regarded as a tool for levelling the playing field between firms, which could compete to acquire co-location space, and trading venues. However, concerns were expressed around ensuring venues provided equality of access to participants, including transparency of pricing, and that regulatory action to ensure this might be warranted. Some respondents felt that access to co-location should be limited to regulated firms and venue members, whereas others felt a broader range of interested parties (e.g. data vendors) should be able to use co-location space as well. In addition, some were concerned that lower latency might facilitate abusive strategies, or that its costs might be prohibitive for some.

7.1.4 Fee structures

209. Responses reflected that many venues had moved towards the maker/taker model in recent years, recognising the importance of liquidity providers in the markets and encouraging order flow. Importantly, respondents felt that fee structures should remain a purely commercial issue but that trading venues should ensure their fees were transparent to all market participants.

7.1.5 Tick sizes

210. Almost all market participants agreed that the reduction in tick sizes had helped tighten bid-offer spreads, with some arguing that this had helped increase liquidity and reduce volatility. However, other argued that small tick sizes might fragment liquidity at the top of the order book or allow participants to edge their orders ahead at minimal cost. In terms of harmonising tick sizes across the markets, some felt that existing industry initiatives had been sufficient. However most perceived at least a "back-up" role for regulators in this area to ensure tick sizes were reasonable and standardised.

7.2 CESR Action Plan on Micro-structural Issues

211. Based on the above responses to the Call for Evidence on micro-structural issues, CESR proposes the following actions.

7.2.1 High frequency trading

212. CESR considers that further work is necessary to better understand high frequency trading strategies and the risks that they pose to the orderly functioning of markets.

213. CESR considers that further scoping work is necessary (including consultation with industry) to develop some specific guidelines on the application of appropriate systems and controls for investment firms and trading platforms in a highly automated trading environment (e.g. volatility measures/circuit breakers for trading platforms in the context of pan-European trading).

214. CESR recommends that further work be done on direct members of RMs/MTFs that currently fall under the MiFID Article 2(1)(d) exemption for non-market making firms that trade only on a proprietary basis. As a starting point, this work should include a fact finding exercise on RM/MTF members that are not investment firms and which account for significant volumes on any given trading platform.

7.2.2 Sponsored Access

215. CESR considers that guidance on sponsored access is necessary. CESR notes that a considerable amount of work has been done at domestic and international levels to establish high-level standards for sponsored access arrangements. In addition, there are existing

provisions in MiFID that could be applied to investment firms and trading platforms in the context of these arrangements (e.g. organisational requirements for investment firms and RMs/MTFs).

216. Accordingly, CESR recommends that further work be done (including consultation with industry) to develop specific guidelines on sponsored access. This work should identify the risks from 'naked' access and focus on pre- and post-trade controls, outsourcing arrangements and consider the implications for both investment firms and trading platforms.

217. As a result, CESR recommends the Commission amend Level 1 (and, where appropriate, Level 2) so as to include a specific reference to ESMA competence to develop binding technical standards in precisely defined areas as regards RMs/MTFs organisational requirements. These standards would not involve broad policy choices, but would specify requirements in focused areas relating to fair and orderly markets, including sponsored access. Pending the revision of MiFID, such requirements for sponsored access could be dealt with under CESR guidelines.

7.2.3 Co-location services

218. CESR considers that existing MiFID provisions could be applied to co-location services (e.g. RMs/MTFs must have transparent rules, based on objective criteria, governing access to their systems/facilities). Accordingly, CESR recommends that further scoping work be done (including consultation with industry) to develop specific guidelines on the application of MiFID to these arrangements. Guidelines should focus on co-location arrangements provided by trading platforms (either directly or via an outsourcing agreement) and provide that services (including fees) are transparent and available to trading participants on an objective basis.

219. As a result, CESR recommends the Commission amend Level 1 (and, where appropriate, Level 2) so as to include a specific reference to ESMA competence to develop binding technical standards in precisely defined areas as regards RMs/MTFs organisational requirements. These standards would not involve broad policy choices, but would specify requirements in focused areas relating to fair and orderly markets, including co-location services. Pending the revision of MiFID, such requirements for co-location services could be dealt with under CESR guidelines.

7.2.4 Fee structures

220. CESR considers that existing MiFID provisions for RMs/MTFs could be applied to fee structures (e.g. RMs/MTFs must have transparent rules, based on objective criteria, governing access to their systems/facilities). Accordingly, CESR recommends that further scoping work be done (including consultation with industry) to develop a proposal on how MiFID provisions should apply to these arrangements. This proposal should focus on providing that fee structures are made transparent and available to members on an objective basis.

221. As a result, CESR recommends the Commission amend Level 1 (and, where appropriate, Level 2) so as to include a specific reference to ESMA competence to develop binding technical standards in precisely defined areas as regards RMs/MTFs organisational requirements. These standards would not involve broad policy choices, but would specify requirements in focused areas relating to fair and orderly markets, including fee structures. Pending the revision of MiFID, such requirements for fee structures could be dealt with under CESR guidelines.

7.2.5 Tick size regimes

222. Based on the responses to the call for evidence, CESR does not consider that regulatory intervention is necessary on tick size regimes at this time. However, CESR consider that regulators should have the necessary tools to ensure that variations in tick sizes across trading platforms do not impact on the orderly functioning of the market as a whole. As a result, CESR

recommends the Commission amend Level 1 (and, where appropriate, Level 2) so as to include a specific reference to ESMA competence to develop binding technical standards in precisely defined areas as regards RMs/MTFs organisational requirements. These standards would not involve broad policy choices, but would specify requirements in focused areas relating to fair and orderly markets, including, if needed, tick sizes. Pending the revision of MiFID, such requirements for tick sizes could be dealt with under CESR guidelines.

8. Other MiFID provisions related to secondary markets

223. The obligation to cooperate placed on competent authorities of different Member States under Article 56(2) of MiFID limits itself to the cross-border activities of RMs and does not currently extend to MTFs. However, MTFs have become increasingly significant to secondary market trading across Europe since MiFID came into force. As a result, it is considered appropriate that competent authorities also establish proportionate cooperation arrangements if the activities established by an MTF in a host Member State become of substantial importance for the functioning of the securities markets and protection of investors in that host Member State.

224. CESR therefore recommends that the Commission extend the obligation in Article 56(2) of MiFID for competent authorities to cooperate, such that it extends to the activities of MTFs as well as RMs.

ANNEX I – PROPOSED GUIDANCE FOR APPROVED PUBLICATION ARRANGEMENTS

Dissemination

APAs must publish the information required under Article 27 of the MiFID implementing regulation within the timeframe required under Article 28 of MiFID.

APAs must:

- facilitate the consolidation of the information with similar data from other sources, including making the information accessible by automatic electronic means in a machine-readable way;
- ensure the information is accompanied by instructions outlining how users can access the data;
- make the information available to the public on a non-discriminatory commercial basis at a reasonable cost; and
- provide transparency with respect to the prices charged to end-users of the data;

Security

APAs must ensure there is:

- certainty on a continuous basis as to which firms submit trade information by employing appropriate authentication mechanisms;
- no corruption of data in the input process at the APA; and
- no unauthorised access to trade information at the APA.

APAs must ensure there are controls over their facilities and the individuals providing the services to ensure trade information is monitored securely and confidentiality of the data received is retained, and to prevent the misuse of the information. At a minimum, the following controls must be in place at the APA:

- the working environment must be secure;
- the computer-based systems must incorporate:
  - access controls;
  - procedures for problem management and system changes; and
  - arrangements to monitor system performance, availability and integrity.
- the working environment must be free of unauthorised surveillance;
- individuals providing the APA service must be under a duty to keep confidential any trade information to which they have access; and
- if there is a breach of any security measure relating to the provision of a APA service, the clients involved and the APA's authorising competent authority must be notified immediately and, if requested, a detailed report of the breach must be provided and appropriate corrective steps taken.

Identification of incomplete or potentially erroneous information

APAs must have appropriate systems and controls in place to identify on receipt trade reports from investment firms that are incomplete or contain information that is likely to be erroneous. These systems and controls may include various automated price and volume alerts, taking into account:

- the sector and the segment in which the security is traded;
- liquidity levels including historical trading levels;
- appropriate price and volume benchmarks; and
- if needed, other parameters to be set individually according to the characteristics of the security.

Where an APA determines that a trade report it receives from an investment firm is incomplete or contains information that is likely to be erroneous, it must ensure it does not publish this information. It must alert the investment firm that the trade report is incomplete or contains information that is likely to be erroneous and has not been published.

An APA must review its systems periodically and adjust them when necessary.

Correction of trade information

An APA must have the ability to amend a trade report itself when a firm cannot do so for technical reasons in exceptional circumstances. The APA is not otherwise responsible for correcting information contained in trade reports. Where an APA determines a trade report is incomplete or contains information that is likely to be erroneous and therefore does not publish the trade, the investment firm must correct the trade report and publish a complete and accurate trade report as soon as the error is detected.

Monitoring

An APA must have the capability to monitor its own systems and controls to ensure with reasonable certainty that the trades it monitors have been successfully published.

Operational hours

An APA must be capable of monitoring trade reports throughout the normal trade publication hours of the investment firms submitting trade reports to it, irrespective of the time zones in which those investment firms operate. This must include providing for trades published under MiFID's deferred publication regime.

Resources and contact arrangements

An APA must have appropriate numbers of staff overseeing the APA service who are competent to perform their duties and meet the requirements for APAs.

An APA must have a nominated individual responsible on a day-to-day basis for the performance of the APA's functions and its compliance with these standards. An APA must provide its clients with contact details for this person.

An APA must provide a facility for market participants to query the accuracy of the trade publications it disseminates and must have procedures in place for market participants to raise complaints regarding the APA's services and activities. The facility must be operational throughout the normal trade publication hours of the investment firms submitting trade reports to the APA so that queries can be addressed promptly.

Recovery provisions

An APA must provide adequately for possible disruptions to its operations in order to enable the timely resumption of publication in the case of system failure. It must have arrangements to ensure IT systems are not prone to failure and must ensure business continuity if a system or systems failed. This must include system "fail-over" arrangements to minimise the risk of disruption to the APA's service.

An APA must regularly review these provisions and ensure they remain sufficient to ensure there is minimum disruption to the continuous operation of its service. An APA must inform its clients without delay if its operations are disrupted.

Conflicts of interest

APAs must have appropriate arrangements for managing conflicts of interest. In particular, appropriate control and governance structures must be in place to ensure that staff in the APA's surveillance function do not come under undue pressure or influence from the APA's commercial functions.

Outsourcing

Where an APA arranges for functions to be performed on its behalf by third parties, the APA must be satisfied that the person performing the function is fit, able and willing to perform the function. An appropriate contract must be in place to cover the outsourced functions, with accompanying service level agreements. In addition, the APA must satisfy itself that such a third party has recovery provisions in place akin to those outlined above.

Regulatory reporting responsibilities

Periodic report

The information that an APA must provide on a periodic basis to the competent authority of each investment firm using the facilities of the APA must include (but may not be limited to) the proportion of information to be made public received by the APA from the investment firm that:

- The APA did not publish because the information was incomplete;
- The APA did not publish because the information was likely to be erroneous;
- Were later cancelled by the investment firm;
- Were later amended by the investment firm; and
- Were not received by the APA within the time required under Article 29(5) of the MiFID Implementing Regulation or the delays allowed under Article 28 of the MiFID Implementing Regulation.
- Were flagged as being either incomplete or likely to be erroneous that were resubmitted and the resubmitted trade was then subsequently cancelled or amended

Each APA must provide to the competent authority of each investment firm:

- A measure of average time taken to resubmit corrected trades that the APA flagged to the investment firm as being either incomplete or likely to be erroneous; and
- a measure of the average time between a trade first being published and it later being either cancelled or amended

Ad hoc reports

Where an APA considers that an investment firm is consistently providing poor quality data, it must in the first instance inform the investment firm of its concerns. If the submission of poor quality data continues, the APA must report its concerns to the investment firm's competent authority.