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TECHNICAL ADVICE

**CESR Technical Advice to the
European Commission in the
context of the MiFID Review –
Transaction Reporting**



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Executive summary

In the light of the ongoing MiFID Review of the European Commission, CESR provides its advice to the Commission on possible amendments to MiFID and its Implementing Regulation on transaction reporting.

This paper sets out CESR's proposal for amending the transaction reporting regime under MiFID. The key purpose behind the suggested amendments is to improve market supervision.

The proposed main amendments focus on the following areas:

- Introduction of a third trading capacity (client facilitation);
- Collection of client and meaningful counterparty identifiers – CESR suggests to the European Commission that the collection of client IDs and meaningful identifiers for all counterparties and its submission to competent authorities would be made mandatory in all Member States
- Standards for client and counterparty identifiers – CESR elaborates on possible guidance and future standards for client and counterparty identifiers;
- Client ID collection when orders are transmitted for execution - CESR suggests amending MiFID to enable Member States to require that, when orders are transmitted for execution, the transmitting firm either provides the client ID to the receiving firm or reports the trade, including full client ID, to the Competent Authority; and
- Transaction reporting by market members operating under the Article 2(1)(d) exemption - CESR suggests amending MiFID by introducing a transaction reporting obligation to those persons that are members of a regulated market or MTF or, alternatively, by introducing a similar obligation on regulated markets or MTFs that admit these undertakings as members.

1 INTRODUCTION

1. In the course of the ongoing MiFID Review by the European Commission, CESR would like to provide its advice on possible amendments to MiFID and its Implementing Regulation regarding transaction reporting provisions.
2. Within the overall MiFID framework and with regard to CESR members' obligation to monitor the activities of investment firms to ensure that they act honestly, fairly and professionally and in a manner which promotes the integrity of the market, Article 25(3) of MiFID obliges investment firms to report executed transactions to their competent authorities.
3. Transaction reporting data is needed to enable supervisors to detect and pursue suspected instances of market abuse, client abuse or other breaches of relevant MiFID provisions.
4. MiFID transaction reporting regime is based on reporting of executed transactions and not on information on individual orders. In that regard, Article 5 of the MiFID Implementing Regulation clarifies that for these purposes 'transaction' is a reference only to the purchase and sale of a financial instrument, excluding securities financing transactions, the exercise of options or of covered warrants, primary market transactions (such as issuance, allotment or subscription) in financial instruments falling within Article 4(1)(18)(a) and (b) of MiFID.
5. Article 13 of the MiFID Implementing Regulation and its Annex I set out the content of the transaction reports that investment firms that execute transactions in financial instruments admitted to trading on a regulated market have to report to their competent authorities.
6. Since the drafting of the MiFID Implementing Regulation CESR members have been aware of the difficulties in achieving an entirely homogeneous transaction reporting system across Europe. As the transaction reporting systems and market structures were considerably different, CESR proposed in its advice to the European Commission not to impose a single system to investment firms, but to build on the existing systems in order to avoid unnecessary costs for investment firms. The exchange of transaction reports would therefore be organised only between securities regulators, each regulator having the responsibility to collect necessary transaction reporting data from the firms it supervises, according to its specific arrangements.
7. To address the technical impact on market participants that the lack of a more convergent approach could cause, CESR published the CESR Level 3 Guidelines on MiFID Transaction Reporting (Ref. CESR/07-301) in May 2007. The guidelines covered non-technical issues where there was a need for a harmonised approach by CESR members: transaction reporting by branches; scope of the transaction reporting obligation (i.e. what constitutes 'execution of a transaction' for transaction reporting purposes); and approval of reporting channels.
8. In that document, after considering necessary to separate execution of a transaction from reception and transmission of orders, it was also acknowledged that there are many different circumstances in which transactions take place, being impossible at that stage to reach a total agreement on the concept of 'execution of a transaction' consistently applicable across Member States. Moreover, it was recognised that competent authorities have a justifiable need to specify under which circumstances transactions are executed and hence need to be reported.
9. However, in order to establish a minimum level playing field and facilitate the implementation of MiFID, CESR members agreed to exchange the information in points (a) and (b) below and, if requested and when available, the information in point (c):
 - a) *information relating to transactions conducted by the investment firms transacting directly with an execution venue (immediate market facing firm);*
 - b) *information relating to transactions not covered by (a) above but where the investment firm is undertaking the transaction on its own accounts (regardless whether the transaction is executed on an RM or MTF or outside them); and*

c) *information which is necessary to identify the ultimate client on whose behalf the transaction is undertaken or information which is necessary to establish the identity of the investment firm which is dealing with the ultimate client where the competent authority is not already in possession of such information or where it could not obtain such information in a sufficiently timely manner.*

10. Item c) above was included since CESR members agreed that in addition to transaction reports, competent authorities need other information on the different steps of executing a transaction. Due to the different practices from member to member, further information (including the identity of the originator of the order) may be collected as part of the transaction report or it may be acquired by other means (for example ad hoc requests that can take place ex post).
11. These guidelines were considered an interim solution. Regarding the scope of the transaction reporting obligation, CESR committed to launch a review of them after there had been a year's experience of full operation of the MiFID transaction reporting regime with a view to producing definitive guidance in this area which aims at converging practices between CESR members.
12. To this end, CESR launched a Call for Evidence on 3 November 2008 (Ref. CESR/08-873), inviting all interested parties to submit their views as to what CESR should consider when conducting the review of the scope of the MiFID transaction reporting obligation.
13. In the responses received, a need for greater consistency of approach to the interpretation and implementation of MiFID was made clear. Respondents to the Call for Evidence requested CESR to include into its review such elements as the harmonisation of the standards for the use of client and counterparty identifiers within a transaction report, the regulatory uncertainty regarding the firms falling under the transaction reporting regime or the need to clarify which transactions on non-EEA exchanges should be reportable.
14. From the responses and internal discussions held within CESR, the existence of significantly different interpretations of some key terminology relating to transaction reporting also became evident.
15. Another issue identified at this stage was the possibility to analyse whether information helping to identify the beneficiary of a transaction should be included in the transaction reporting requirements (the so called 'client-side' reports described in category c) of the Level 3 Guidelines).
16. Jointly with the consideration of the benefits and drawbacks of including such client-side information in transaction reports in order to meet the market monitoring obligations of competent authorities described in Article 25(1) of MiFID, the eventual harmonisation of the standards for the use of client and counterparty identifiers within a transaction report were analysed.
17. On the basis of the work conducted and following the public consultation on Technical Advice to the European Commission in the context of MiFID review – Transaction Reporting (Ref. CESR/10-292), CESR submits its proposal to the European Commission on the following issues
 - Key terminology supporting the concept of transaction reporting – trading capacity and distinction between clients and counterparties;
 - Factors impacting the collection of client and meaningful counterparty identifiers;
 - Possible standards for client and counterparty identifiers; and
 - Client ID collection when orders are transmitted for execution

2 KEY TERMINOLOGY ON TRANSACTION REPORTING

18. In order to progress towards harmonising transaction reporting requirements, this section focuses on some of the basic terminology. This includes trading capacity (i.e. the distinction between principal and agency trading and the eventual ‘grey’ areas) and client and counterparty. These discussions are exclusive to transaction reporting.

2.1 Trading Capacity

19. When analysing the different transaction reporting schemes that may take place, the role played by the investment firm(s) involved is one of the key points that is necessary to understand. Field 5 in Table 1 of Annex I of the MiFID Implementing Regulation provides only two possibilities to identify the trading capacity of the reporting investment firm:

1. on its own account (either on its own behalf or on behalf of a client);
2. for the account, and on behalf, of a client.

20. This suggests that MiFID only intended to allow a single choice when the investment firm reports; i.e. either as principal (‘P’) or as agent (‘A’).

21. CESR considers that the key distinction between a principal transaction and an agency transaction envisaged in MiFID is that in a principal transaction the buying firm takes ownership of the instrument (no matter how briefly) whereas in an agency transaction the firm never takes ownership of the instrument (as it acts on behalf of the “client” who takes ownership of the instrument). So, in an agency transaction, an investment firm acts for the account, and on behalf, of a client.

22. However, some market participants do not agree that these two categories of principal and agency can adequately describe all the possible trading capacities a firm can operate in. Some argue that there remains a ‘grey’ area for those transactions executed by the investment firm on its own account and on behalf of the client and that these transactions do not fall into the category of either principal or agency. This latter category differs from a ‘pure’ agency trade in that the firm actually takes ownership of the instrument (sometimes momentarily) before a separate transaction is made to ‘hand over’ the financial instrument(s) to the “client”. This second transaction is almost always an “off-market” transaction¹.

23. These principal transactions made by a firm on its own account and on behalf of the client may have different names across Europe (e.g. “riskless principal”, “back to back transaction”, “on account of client in firm’s name” and “commissionaire”). Whilst these transactions do not appear as agency transactions, they are still executed on behalf of a client rather than compromising the proprietary capital of the executing firm. This scenario typically happens when two matching trades are entered at the same time and price with a single party interposed following a client’s order.

24. CESR therefore identifies three possible scenarios where an investment firm executes a transaction:

- It acts on its own account and on its own behalf (pure principal transaction – i.e. on the decision of the firm);
- It acts for the account and on behalf of a client (pure agency transaction); and
- It acts on its own account and on behalf of a client – i.e. on the order of the client.

25. The third scenario makes supervision of these trades difficult, since they are currently reported in many countries (and exchanged through TREM) as principal trades while their nature is

¹ CESR also understands that some derivative markets operate on a “principal-to-principal” capacity whereby a client order will generate two contracts and two principal transactions, both of which are deemed to have traded on the exchange.

closer to an agency trade, since the initiative to trade and the corresponding order come from a client of the firm.

26. It is worth noting the difficulty in reaching harmonisation on the treatment of transactions covered in the third scenario above as different legislation or practices across Member States result in some CESR members defining such transactions as two separate transactions whilst other members define them as a single transaction. CESR considers that there are three possible practical solutions to reporting transactions falling in the third scenario described above in a transaction report.
27. Firstly, they can be treated as two separate principal transactions with the counterparty field populated but the client field left empty in both transaction reports.
28. Secondly, these transactions can be represented in a single principal transaction report with both the counterparty and client fields populated. The originator of the transaction should be entered into the client field. It should be noted that with this option, the client field would have to be populated in all Member States. Under the existing legal framework, for those Member States collecting the client ID, a meaningful code must be entered. For those Member States currently not collecting a client ID, the client field could, for instance, be populated with the word "client". (Please note the discussion later in this document on the use of client ID).
29. A third option is to create an additional trading capacity as these transactions cannot be classified simply as agency or principal. However, a change of the MiFID Implementing Regulation (Annex I, Table 1, Field 5: Trading capacity) is required for this. Like option two above, the "riskless principal" transactions would be represented in a single transaction report with the originator of the transaction being identified in the client field if populated. (Please note the discussion later in this document on the use of client ID).
30. Another topic, different from the trading capacity debate, is the one on trades done through a market-making arrangement. The current possibilities provided for in MiFID do not allow for identifying transactions performed by market makers (liquidity providers, specialists, etc.). Transactions carried out by them have features that may justify marking such transactions in order to differentiate them from ordinary transactions for supervisory purposes. They respond to a commitment by an investment firm to operate in the market with the goal of providing liquidity to a particular security. The market maker or liquidity provider may channel client orders or even operate on own account on the same financial instrument in a particular trading session. There is some interest, from a supervisory point of view, to be able to differentiate trades done in the capacity of liquidity provider and the rest.
31. However, the definition of the activity of market making or liquidity provision should be carefully considered. The aim would be to capture only transactions that respond to a stable and publicly known arrangement by an investment firm that is committed vis-a-vis an issuer or a trading venue, to provide liquidity in a predefined manner. Therefore, transactions identified as such would not include "discretionary" market making, in the line of the definition included in Article 4(8) of MiFID, but a more stable, public and precise activity regulated by some kind of market rule or practice.
32. Despite the above, taking into account that the number of this kind of arrangements is normally small in each market and that, due to the public nature of those arrangements, supervisors are normally aware of the role that a particular investment firm plays on certain financial instruments, CESR is of the view that the addition of some kind of a harmonised flag or indicator by all market makers and liquidity providers at EU level, while useful in some cases, is not essential and could be left to the discretion already available for competent authorities.

Conclusions

33. CESR considered in its consultation paper on Transaction Reporting (Ref. CESR/10-292) the introduction of a third trading capacity (riskless principal) to be the best and most robust way forward and that the MiFID Implementing Regulation should be amended accordingly. However, there was significant opposition to this proposal from some firms and industry bodies

principally due to the extreme difficulty firms might face in matching the market side transactions of the “riskless principal” transactions with the client side transactions. Firms also noted that CER had not provided a clear definition of the new trading capacity and, as a result, this might increase the number of transaction reporting errors and inconsistencies across the EEA. CESR acknowledges the merit in both these arguments and has decided to modify and clarify its proposal as follows:

Trading capacity must be populated with one of the following three values:

1. Principal for own account (P)
2. Principal as part of a client facilitation (F)
3. Agency (A)

34. The definition for agency capacity remains unaltered, but principal has been split into those transactions that the firm undertook as a result of its own trading decisions and those that it undertook as a result of a client order. Typically, two transaction reports should be submitted by an investment firm for the client facilitation trades – one showing the 'market side' transaction and a second showing the 'client side' transaction. In each of these transactions, the counterparty field should be populated (with client's ID in the counterparty field when reporting the “client leg”), but **not** the client field. CESR believes this solves the difficulties for firms needing to link the market side and client side transactions in a single report whilst enabling regulators to note that the reporting firms were not the initiators of a transaction. The following scenarios demonstrate this client facilitation:
35. Scenario 1 – Investment firm 'X' receives an order from client 'A' to buy 10,000 shares in stock 'Z'. The investment firm satisfies the order by making a principal transaction on the market and a principal transaction to the client.² The investment firm should submit the following transaction reports to its local regulator:³

Reporting Firm	BIC for X
Time	10:05:26
Trading Capacity	F
Buy/Sell Indicator	B
Counterparty	BIC of CCP or MIC
Client	
Quantity	10000

Reporting Firm	BIC for X
Time	10:05:26
Trading Capacity	F
Buy/Sell Indicator	S
Counterparty	Code of the client
Client	
Quantity	10000

NB: client field is blank in both transaction reports

36. Scenario 2 – Investment firm 'X' receives three orders to buy 10,000, 15,000 and 30,000 shares from clients 'A', 'B' and 'C'. Investment firm 'X' satisfies these orders by buying 50,000 shares from London Stock Exchange CCP and 5,000 from investment firm 'Y'.

Reporting Firm	BIC for X
Time	11:21:00
Trading Capacity	F
Buy/Sell Indicator	B
Counterparty	BIC of LSE CCP
Client	

² It is noted that the investment firm might choose to represent this scenario in a single agency transaction report **if** the transaction was conducted on an agency basis.

³ Only the key features of the transaction reports are shown in these examples – not all the required fields.

Quantity	50,000
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Reporting Firm	BIC for X
Time	11:23:42
Trading Capacity	F
Buy/Sell Indicator	B
Counterparty	BIC of Y
Client	
Quantity	5000

Reporting Firm	BIC for X
Time	11:24:05
Trading Capacity	F
Buy/Sell Indicator	S
Counterparty	Code of client A
Client	
Quantity	10000

Reporting Firm	BIC for X
Time	11:24:05
Trading Capacity	F
Buy/Sell Indicator	S
Counterparty	Code of client B
Client	
Quantity	15000

Reporting Firm	BIC for X
Time	11:25:05
Trading Capacity	F
Buy/Sell Indicator	S
Counterparty	Code of client C
Client	
Quantity	30000

NB: Client field is empty in all examples. Time does not have to be identical in all transaction reports.

Proposal

37. CESR suggests amending the MiFID Implementing Regulation by introducing a third trading capacity – client facilitation.

2.2 Client and Counterparties

38. Under the existing EEA transaction reporting framework, the terms “client” and “counterparty” and how they are distinguished are particularly important, as there are two separate fields in a transaction report for these elements and any confusion may result in competent authorities (CA) misunderstanding whether the parties have bought or sold. This is because the buy/sell indicator in a transaction report (i.e. Field 4 in Table 1 of Annex I) indicates the action of the entity in the client field – the entity in the counterparty field (i.e. Field 20 of Table I) has actually taken the opposite action to that indicated by the buy/sell field.
39. Article 4(10) of MiFID provides a definition of client for the provision of investment services (“client means any natural or legal person to whom an investment firm provides investment and/or ancillary services”). However, from a transaction reporting perspective, a client can be identified in two ways in a transaction report:
- In the counterparty field (Field 20), where the investment firm is operating in a principal capacity; or

- In the client field, if required locally, where the investment firm is operating in an agency capacity.

40. So, it is essential to distinguish counterparties from clients for the following reasons:

- CESR members are obliged under MiFID to collect counterparty identifiers (Field 20), at least for investment firms, regulated markets, MTFs or CCPs, but currently have the option to collect or not to collect client identifiers.
- The meaning of the buy/sell indicator (Field 4) is the opposite for the entity in a counterparty field (Field 20) to that for the entity in the client field.
- Client fields are populated at least for agency transactions (indicated by an ‘A’ in Field 5) (if required by national regulations), but the counterparty field (Field 20) is populated in all transaction reports.

41. This is illustrated in the following examples:

Example 1. – Individual D instructs his broker, investment firm N to buy stock Z. N would act as agent for D and buy stock from the market. The investment firm would submit a single transaction report with an agency trading capacity, the market CCP, for instance, as counterparty and a client identifier in the client field (if required by the CA). The buy/sell indicator is “B” since the investment firm is acting as an agent of the client, who is buying stock from the market.

Example 2. Company C is a client of Investment Firm Y and wants to buy stock Z. Investment Firm Y sells to C as principal. Company C will then be the counterparty for transaction reporting purposes. In this example, the buy/sell indicator is S because Investment Firm Y acted as principal and thus should report from its own perspective.

Conclusions

42. On the basis of responses received by CESR to the consultation paper on Transaction Reporting (CESR/10-292) it became evident that respondents were generally supportive of CESR’s analysis on distinguishing the terms “client” and “counterparty” for transactions reporting purposes. CESR, therefore, does not see any need for suggesting amendments to MiFID in this regard to the European Commission.

3 COLLECTION OF THE CLIENT IDENTIFIER/MEANINGFUL COUNTERPARTY IDENTIFIERS

43. This section looks at the collection of client identifiers and its pros and cons.

3.1 Legal framework

44. Article 13 of the MiFID Implementing Regulation and its Annex I set out the content of the transaction reports that investment firms which execute transactions in financial instruments admitted to trading on a regulated market have to report to their competent authorities.
45. In addition to the data set out in Table 1 of Annex I, Article 13(3) of the MiFID Implementing Regulation permits Member States to require additional information than that specified in Table 1 of Annex I. Moreover, Article 13(4) of the MiFID Implementing Regulation gives Member States the possibility to require transaction reports to identify the clients on whose behalf the investment firm has executed the transaction. Reporting of client identifiers is not compulsory under Article 25(4) of MiFID.
46. This legal flexibility allows Member States to perform their market monitoring and supervision in different ways: either by requiring a systematic reporting of additional information including the client ID or acquiring it on an ad hoc basis, when a trade seems to be suspicious. It takes into account the different practices, structures and sizes of the markets of the Member States.

3.2 Competent Authorities' policies on collecting client identifiers

47. The different rules adopted with respect to client ID collection in the EEA Member States can be summarised as follows: in 19 out of 29 Member States, client information is required in transaction reporting. Therefore a broad majority (more than 65% of CESR members) already request client information in transaction reporting.
48. Of the 10 CESR members which do not currently require client information, some are considering whether to request client information in the near future.
49. Where the client is an investment firm/credit institution, most CESR members that request client information require a BIC code. If a BIC code does not exist, the reporting firm should, in most Member States, use a unique and consistent internal reference code. In two Member States (Germany and Austria), the investment firm/credit institution can choose between certain options such as a BIC code, a unique code for the firm determined by CA/National Bank or other types of local identification codes, for example stock exchange ID or banking routing number.
50. Where the client is not an investment firm/credit institution, most CESR members that request client information require a unique (format free) client code (together with the BIC code of the reporting firm) on the level of the investment firm (e.g. UK). Three Member States (Germany, Austria and Sweden) request a unique (format free) client code on the level of a securities account. In that case, a client with more than one securities account will have different client IDs. Some Member States (Norway, Spain, Portugal, Czech Republic and Malta) use a unique identification number, for example: taxpayer number, personal identity number, business enterprise organisation number, identification number assigned by the National Bank or name of the party entering into the transaction.
51. Three different levels of uniformity are currently used for clients who are not an investment firm/credit institution:
 - a. Unique identification number independent of the investment firm/credit institution (for example taxpayer number);
 - b. Unique identification number on the level of the investment firm/credit institution; and
 - c. Unique identification number on the level of a securities account (for example the bank/securities account number)
52. Most Member States currently request the second option.

3.3 Advantages and disadvantages of collecting client identifiers

53. Many of the arguments for collecting, or not collecting, client identifiers can equally be applied to collecting identifiers for counterparties that are not investment firms, regulated markets, MTFs or central counterparties. So references to client identifiers in section 3.3 and 3.4 should be taken to include entities that might otherwise be identified in the counterparty field as "customer/client".
54. CESR identified a number of benefits provided by the collection of client/counterparty identifiers. These benefits are further explored in paragraphs 55 to 66.
55. All the competent authorities that collect client IDs currently place great value on the input they provide for market surveillance purposes and rate the usefulness of client IDs as very high.
56. The main purpose of collecting transaction reports is to help CAs meet the obligations of MAD. To meet these obligations, many CAs consider that it is essential to identify the initiator or beneficiary of a trade within the transaction report to enable the detection of market abuse and to protect the integrity of the markets. For many markets, this cannot be done simply by collecting reports on transactions made by investment firms transacting directly with an execution venue. Supervisory signals at firm's level have proved much less precise and much less useful for supervisory purposes than those based on client data.

57. Member States where client ID is regularly collected have seen a decrease in the likelihood of false positives (considering suspicious at firm's level what would be a non-suspicious set of trades at client's level) and false negatives (considering as non-suspicious certain trades that, when attached to a particular client, were clearly suspicious). Without a client identifier, it would be impossible for the CA to deduce certain information from the transaction reports without ad hoc requests, which, in turn, increases compliance costs for firms and CAs. Therefore, client IDs can improve the efficiency of supervision.
58. Category c) in the current CESR Level 3 Guidelines essentially offers CAs the choice to collect client identifiers as part of the transaction reports or collect them on an ad hoc basis. For many markets it is not practical to collect client information on an ad hoc basis as the CA may collect up to seven million transaction reports a day. The CA might end up sending huge and onerous requests to firms for information when further client information would have clearly shown that nothing suspicious had transpired. This burden comes as a cost to the firms and can be upsetting for them if they have already provided client identifiers to help CAs detect truly suspicious transactions.
59. It is important to note that this process can slow down the speed and efficiency of any investigation. Additionally, the ability to immediately identify suspicious client transactions or, just as importantly, to identify certain transactions as non-suspicious, significantly reduces the burden on the CAs, as well as the firms from which information is being sought. Increasingly, transactions are being carried cross-border. In such an instance, suspicious transactions of a firm based in another EEA Member State which does not contain client-identifying information may lead to a request by the investigating CA (the requesting CA) for assistance to the CA in another country (the assisting CA). This will then, dependent on the procedures of the requesting CA, lead to a request by the assisting CA for information from the relevant firm, to be provided within a specified period of time, typically 10 to 15 days. The request will then be answered and the response provided to the assisting CA who will in turn pass the information along to the requesting CA. This process typically takes between three and four weeks and often results in the firm identifying yet another firm as the client for whom the transaction was carried out when in fact the true beneficial owner of the securities is a client of the second firm. This can lead to an additional request for assistance in an effort to pinpoint the true beneficial owner. With the client-identifying information readily available, this initial step or steps can be rendered unnecessary and can thus result in substantial savings of both time and resources for the requesting CA as well as for the firm and the assisting CA. Due to the large number of market moving events, it is particularly valuable to pinpoint the suspicious accounts of interest as soon as possible.
60. Client identifiers are also useful as they enable profiles of clients' behaviour to be developed in an automatic way. For example, we might find that a seemingly suspicious client actually trades thousands of times a year and loses money as often as he profits. Conversely, we might find that a client always profits from his transactions or always makes profitable transactions ahead of events involving a certain party. This advanced intelligence is totally dependent upon client and counterparty identifiers.
61. Since CAs are obliged to collect counterparty identifiers (at least for investment firms) it may appear inconsistent that they do not collect client identifiers for agency transactions as well. Many CAs view agency transaction reports received from other CAs without a client identifier, or principal transaction reports with the counterparty identified as "customer/client", as additional "noise" that actually detracts from their ability to focus on truly suspicious transactions.
62. Short selling has become an increasingly important topic and many CAs have implemented new regulations to limit or force disclosure of this activity. CESR has also recommended measures relating to short selling in its Report on CESR model for a pan-European short selling disclosure regime (CESR/10-088) and Report on technical details of the pan-European short selling disclosure regime (CESR/10-453). It is impossible to police such regulation through the identification of investment firms alone and many CAs have noted that many of the parties involved in short selling are hedge funds outside the EEA. The use of client identifiers in

transaction reports would undoubtedly help CAs police their short selling rules in the analysis by the regulators of the short positions notified to regulators or published.

63. Many firms and CAs have undertaken considerable expense in providing these identifiers and building systems to take full advantage of the information provided. If the harmonisation of standards resulted in an agreement not to collect these identifiers, it would result in significant wasted costs to firms and regulators that currently require them.
64. Costs of ad hoc requests by CAs to firms to gather information about their clients' IDs would shrink significantly if these IDs were routinely collected and reported as the regulators could better filter out the cases to investigate further.
65. Requiring the collection of client ID may also assist investment firms to comply with other regulatory obligations which involve the management of client data (e.g. large exposures, liquidity risk reporting, anti-money laundering and credit exposures reporting).
66. Summarising, the collection of client-side information in transaction reports is extremely valuable as a large element of suspicious market behaviour can be detected based on client trading patterns (as well as reporting firm trading patterns). It undoubtedly allows authorities to reduce the amount of additional requests sent to firms, though not eliminating them completely. Without client identifiers, the transaction reports may offer little additional value to trade reports for market monitoring. It should also be noted that attempts to spot suspicious transactions only by the reporting firms is seriously compromised by the fact that it is unclear from a principal transaction whether it was conducted by the firm as a proprietary account or as part of client facilitation.
67. However, CESR acknowledges that collecting client identifiers might also have several disadvantages. They are further elaborated in paragraphs 68 to 74.
68. It should first be noted that the collection of client identifiers is not a prerequisite for effective market supervision, as some CESR members have in place surveillance systems and methods with proven records in terms of market abuse investigations and sanctions whereby the client identification is obtained in an ad hoc way, when needed.
69. The present variety among CESR members in requirements to collect client identifiers leads to the following problems, which were also identified by some respondents to the Call for Evidence.
70. In situations where multiple legs in a chain of transactions have to be reported in order to provide the information on client ID, it results in additional records in the TREM system that can (in some cases) be deemed redundant.
71. The introduction of systematic collection of the client ID would mean additional costs (mostly one-off, both for firms and CAs) in the 10 Member States that are currently not collecting it. In fact they would have to adapt their reporting systems accordingly, bear additional administrative workload linked to the input of the client ID and, in some cases, extract the correspondent legs in order to reconcile the information related to the same transaction (for example, as mentioned above, when multiple legs in a chain of transactions have to be reported in order to provide the information on client ID).
72. Moreover, these new costs could be passed on to investment firms' clients, typically with a relevant share of retail investors in those Member States that at present time are not collecting client IDs.
73. In case information on the ultimate client is required to be included in transaction reports on a general basis, attention will have to be paid to investment firms outsourcing transaction reporting to a third party or relying on the waivers provided for in MiFID because this information is not available to the latter or is subject to other conditions.
74. Finally, it should be noted that the introduction of a mandatory and meaningful client ID for natural persons in the context of transaction reporting will need to be articulated with existing legislation on data protection; attention needs to be paid that the regime, including the exchange of data between competent authorities through TREM, is fully compatible with Directive 95/46/EC.

Conclusion

75. Based on the above analysis CESR believes that the anticipated advantages of collecting client identifiers outweigh the disadvantages identified. The provision of client identifiers and meaningful counterparty identifiers could lead to greater efficiencies in market surveillance and the detection of market abuse. The vast majority of CESR members aim, from a surveillance perspective, at increasing the accuracy of the information on clients and exchanging it on a regular basis, since their experience proves this information to be extremely useful for surveillance activities.

Proposal

76. There is a consensus⁴ among CESR members to request the European Commission to amend MiFID and its Implementing Regulation in order to make the collection of client ID and (thus) meaningful identifiers for all counterparties by competent authorities mandatory within the framework of the upcoming review of MiFID⁵.
77. As the introduction of a mandatory and meaningful client ID in the context of transaction reporting (article 25 of MiFID) implies the collection of data that could be of a personal nature, depending on the standard for client identification in each Member State, CESR believes the matter will have to be considered further by the European Commission to ensure full compatibility between client ID data collection under MiFID and Directive 95/46/EC.

4 STANDARDS FOR CLIENT AND COUNTERPARTY IDENTIFIERS

78. CESR consulted on the standards for many of the fields identified in Annex I, Table 1 of the MiFID Implementing Regulation in 2006 (Ref. CESR/06-648b), on the basis of which it was decided that the BIC should be used to identify investment firms in the counterparty field and the client fields (if available and if required by the CA). Decisions on identification codes for regulated markets, MTFs and entities acting as central counterparty were made as well (it was decided to use MIC codes for regulated markets and MTFs and BIC codes for central counterparties).
79. However, BICs are not available for all entities and there is no universally agreed standard identifier to be used for entities such as legal or business entities and natural persons.
80. Undoubtedly, a universal code to identify all entities and persons would be preferable to firm specific client codes as parties can have multiple accounts across many firms, either within the same Member State or in different ones. Unfortunately, such a code does not currently exist and many organisations have discovered the futility in trying to implement such a coding scheme. Indeed, when drafting its Level 2 advice in 2005, CESR already identified this issue for client/customer identification. CESR considered that it was not in a position to propose the use of a unique, European-wide code for a client/customer identification by every investment firm reporting a transaction, considering, first, the technical and cost-related aspects of building from scratch such a pan-European identification code and, second, the political sensitivity of this issue.
81. As already described above in the previous section, when implementing the MiFID reporting obligations, some CESR members that request a client identifier required in their local reporting a unique identification number independent of the investment firm/credit institution to be used. For example, such codes can be existing national standards like the taxpayer number, the personal identity number or the business enterprise organisation number. Some other CAs have also tried to go beyond the firm level by requiring the client name in addition to an internal code set by the investment firm or a national ID code.
82. From a technical point of view, using such coding schemes may not be a major issue for the regulators as most of the Member States requiring the client identifiers use a format free field

⁴ Consensus being defined as unanimity minus one.

⁵ LU objects the proposal in paragraph 76.

in the local reporting system. Similarly, for the exchange of this information between regulators, the current structure of the TREM file is most likely to remain appropriate (a 40 alphanumeric characters field). However, many firms claim that their internal systems will be impacted resulting in implementation costs.

83. Even though the use of a national code for legal or business entities does not raise any data protection issues, the matter may be different for the identification of natural persons. In at least one Member State the collection of national client identification codes within the transaction reports and their processing is subject to national Data Protection Agency approval. Even if such information could be freely exchanged through TREM with regulators from European Union Member States, the possible legal and procedural problems related to data protection to their exchange with CESR members that are not members of the European Union would need to be analysed.
84. Furthermore, some practical solutions would have to be found if personal identification numbers were used at national level, in particular for dual-nationals or in case of joint accounts.
85. The use of the actual name of the persons or entities alone (without combining it with a code) for client identification purposes is not being considered reliable enough due to risks associated with homonymy and the existence of several possible names (commercial, legal, etc.) for the same entity. However, in those Member States where the names together with codes are collected this has proved to be valuable information. This could be kept even if names were not exchanged through TREM (for data protection reasons) and remained at the local CA, in case the investigating CA requested the former more detailed information (names) about particular suspicious transactions.
86. Implementing a code type as universal as possible, and at least beyond the investment firm level, would enable CAs to operate more efficiently, but would have significant cost implications for reporting firms. There might also be legal restrictions for some Member States. However, such a change would have long-term benefits to firms as they would potentially receive fewer information requests from competent authorities.
87. In the view of CESR a possible solution to step from national to pan-European level, at least for natural and legal persons, might be the use of nationality as the leading element⁶. In this case, each Member State could make use of the national code that fits the most its own preferences.
88. Example: Member State A chooses social security number, while Member States B chooses tax payer number. Client Mr. Paul White, of Member State A, has an account both in Member State A and B. Since his nationality is A, he will be identified with his social security number from A, either when executing a transaction via his account in Member State A or via his account in Member State B.
89. Furthermore, European Securities and Markets Authority (ESMA) could play a role in data exchange on client IDs collected through transaction reports in the future provided that European legislation on data protection is complied with.
90. In order to address both the advantages and disadvantages, CESR is investigating the use of a single unique and meaningful identifier for each client or counterparty. Without prejudice of Annex I Table 1 of the MiFID Implementing Regulation and the coding structure already agreed by CESR for investment firms, regulated markets, MTFs and central counterparties, CESR is considering the following guidelines in order to harmonise the standards for the collection of counterparty and client identifiers:
 - a. If a BIC has been assigned to the counterparty (irrespective of whether it is an EEA investment firm or not) or to the client (assuming client identifiers were collected), then it must be used as the identifier in the transaction report when exchanged through TREM.

⁶ CESR is aware that few cases, such as dual-nationals and joint accounts, would not be covered. Although, a possible solution for the first case of dual-nationals could be assuring that each person uses always the same nationality among the ones he has, irrespectively of where the transaction is concluded.

- b. In those cases where a BIC code has not been/could not be assigned, an alternative standard should be used to identify the counterparty or the client.
91. For incorporated entities that are not regulated and to which a BIC code is not assigned, the business enterprise organization number/companies register number seems a suitable solution as a meaningful code for client or counterparty identification, in particular as there is no related data protection issue.
92. The specific case of discretionary or fund portfolio management should also be properly addressed as it is the investment manager who is the initiator of the trade (whether the transaction is eventually carried out for a fund or for a discretionary mandate). Thus, for market surveillance purposes, transaction reports by the intermediary dealing for (or with) the investment manager should identify the investment manager in the client (or counterparty) field.
93. If an investment manager executes a transaction that it reports (e.g. when it is member of a regulated market or an MTF - cf. section 6), it may be considered to use as client identifier the ISIN code for the investment fund (thus avoiding any issue in relation whether or not the fund is legally incorporated) and a unique code for the client under discretionary mandate⁷, though the issue of grouped orders should not be neglected.
94. In the case of 'bulk transactions' carried out in the context of a Dividend Reinvestment Plan, which may have tens of thousands of clients for one transaction, an exemption to the reporting of the client ID could be considered given the passive nature of these types of transaction.
95. In other cases, in particular for natural persons, CESR believes that the alternative standard should be chosen between one of those described below, which have been ranked from the "widest" one - at pan-European level - down to the "narrowest" one - at a securities account level.
96. The standards selected by CESR are the following ones:
- a. Unique identifier at pan-European level, should that code exist at some point in the future, based possibly on any of the following codes:
 - personal identity number;
 - tax payer number (for natural and legal persons);
 - social security number
 - b. Unique identifier at national level, such as any of the following codes:
 - personal identity number;
 - tax payer number (for natural and legal persons);
 - social security number;
 - name of the client (as a complement, not substitute, of the above codes)
 - c. Unique identifier at investment firm level, such as any of the following codes:
 - internal number assigned by the firm;
 - bank/securities account number (provided there is one account per client)
 - d. Unique identifier at securities account level, such as any of the following codes:
 - securities account number;
 - bank account number
97. Each of the standard levels suggested involves different advantages and disadvantages, which are summarised below:

⁷ This unique code should be the same as defined/decided for the general situation.

Pros	Cons
Unique identifier at pan-European level	
i) maximal benefit in terms of surveillance for spotting suspicious clients ii) consistency in the reporting model, improving the integrated financial market iii) minimise the complexity of the reporting and the associated costs for crossborder firms (in the long run) iv) facilitate the exchanges through TREM v) easier to monitor in the detection system	i) need to ensure data protection ii) problematic implementation (incl. time needed – seen by some as a medium to long term solution) iii) how to deal with non EEA natural persons iv) risk of disclosing the client identity along the chain (depending of the nature of the code)
Unique identifier at national level	
i) In principle, unique identifier for any client who is an EEA national ii) Supervisory signals would be at the client level, not the firm's level iii) already used by some Members iv) almost equivalent to the pan-European code in terms of benefits for the surveillance	i) need to ensure data protection ii) anticipated different quality standards of the code in different Member States and difficulties in achieving homogeneous approach due to lack of consistency of available data in different jurisdictions iii) how to deal with non EEA natural persons iv) for groups operating cross border, multiple reporting to the various CAs. v) risk of disclosing the client identity along the chain (depending of the nature of the code)
Unique identifier at investment firm level	
i) easier to implement ii) avoid disclosing a client ID to competitors along the chain iii) already used by some Members iv) improving the implementation of the Know Your Customer requirements by investment firms, to properly identify their clients.	i) differences in specific codes used by firms resulting in aggregation problems for the regulators and ad hoc requests addressed to firms, ii) need to assign only one code to each client across trading activities. iii) not effective as one client can spread its trading activity over a number of different investment firms, iv) wayback for the CAs already collecting at national level
Unique identifier at securities account level	
i) easier to implement ii) avoid disclosing a client ID to competitors along the chain iii) already used by some Members	i) not effective as one client can have several accounts ii) no clear benefit for market surveillance. iii) wayback for the CAs already collecting at firm or national level vi) differences in specific codes resulting in aggregation problems for the regulators and ad hoc requests addressed to firms v) no strong incentive for regulators to invest in automated detection system targeting the client level

98. Any of these solutions is expected to entail costs related to the introduction, maintenance and operation.

99. In principle, CESR considers that the ideal solution would be a unique pan-European code for each person (natural or legal) used for transaction reporting. However, due to the inherent

technical difficulties arising from the creation of such a code, CESR is of the opinion that unique client codes at a national level could reach the same effect, enabling competent authorities to identify the final investors for market surveillance purposes. That would also be consistent with previous proposals put forward in this document. CESR also considers that each competent authority should be free to decide which code should be used for these purposes, taking into account national regulations and practices, as long as they fulfill the aforementioned requirements.

100. If the solution retained is to decide upon the national level for the codes to be used, one should be aware that it is not always possible to allow just one type of code in a certain country for reporting purposes since some persons that can be clients may not have such code (children under age, foreign nationals, certain types of trusts, etc.). Therefore, each competent authority would provide clear rules for populating the client ID field, including a list of acceptable codes with a clear preference order attached to it, an alternative standard being acceptable only if the previous one is unavailable. This design would strike a balance between maximum harmonisation of coding rules and their compatibility with laws and available codes in each country. However, one should be aware that the multiplicity of possible codes at national level implies complicated information management within firms to pass on that information for transaction reporting purposes and prevent any consistency check to be conducted. Additionally, it should be mentioned that a single field for the identification of the client may not be enough to reflect both the client ID and the standard retained. When technical details are defined, there may be a need to identify the type of code and the country of origin of that code, to ensure that transactions exchanged through TREM will be meaningful for the receiving authority.
101. Depending on the type of client code selected at national level, there appears to be merit in some jurisdictions in establishing a central national register containing data which would enable competent authorities, without reverting to investment firms, to establish the identity of a client using the client code entered on a transaction report. Such a register could play a significant role in assisting competent authorities in conducting market surveillance and should reduce the number of queries addressed to investment firms in some countries.
102. The question of whether to collect directly the actual name of the client would be left to national discretion, as long as it complements a certain specific code and is not the sole client ID information collected.

Proposal

103. CESR considers that the ideal solution would be a unique pan-European code for each person (natural or legal) used for transaction reporting. However, due to the inherent technical difficulties arising from the creation of such a code and the lack of harmonised national codes in all Member States, CESR is of the opinion that each Member State should be free to decide which codes should be used for these purposes, taking into account national regulations and practices, as long as they fulfill the aforementioned requirements. Nonetheless, for the purpose of exchanging transaction reports between CESR Members, CESR relies on the use of BIC codes for counterparties and clients (whenever such codes exist) and strongly encourages their use at national level.

5 CLIENT ID COLLECTION WHEN ORDERS ARE TRANSMITTED FOR EXECUTION

104. According to Article 25(3) of MiFID, investment firms shall report executed transactions to their competent authorities. Article 5 of the MiFID Implementing Regulation specifies that for these purposes transaction means the purchase and sale of a financial instrument and specifically excludes securities financing transactions, exercise of options or of covered warrants as well as primary markets transactions.
105. The MiFID regime has proven controversial when addressing the supervisory need to monitor client orders that are transmitted by an investment firm to another one for execution. In cases

where these orders do not carry along the full client ID, the receiving firm cannot populate the final client ID when reporting to its regulator, since it only knows the identity of the transmitting firm. This may lead to a situation where the competent authority receives reports that provide an incomplete picture of the origin of the transaction, since the transmitting firm may not be obliged to report at all. In these cases, the identity of the real client that initiated the trade is lost for supervisory purposes.

106. The importance of this loss of client IDs must not be underestimated: it means a weaker base for market supervision, more costs for firms due to further ad hoc requests by CAs, misleading supervisory signals (as the transmitting firm appears, unduly, as client) and a general loss of precision in the information exchanges through TREM.
107. Some CESR members have already addressed this issue when interpreting the reporting rules and CESR guidelines. CESR is of the view that it is not acceptable to consolidate a reporting regime without trying to make it as accurate and efficient as possible while maintaining the maximum possible harmonisation to facilitate compliance by trans-national firms. Therefore, CESR is of the view that some changes should be considered to the MiFID regime with that purpose.
108. The goal of the changes would be to ensure that client IDs collected are as accurate and meaningful as possible and that they are not lost for supervisory purposes while orders are transmitted from one firm to another.
109. This issue can be looked at as a legal interpretation debate of the term 'execution' versus 'transmission'. However, since solving this problem would require amending MiFID, CESR has focused the discussion, alternatively, to directly analysing specific changes on obligations of reporting firms to ensure that the information reported is accurate and meaningful for the supervisors.
110. CESR envisages two workable ways of reaching the above mentioned goal:
 - Requiring transmitting firms to disclose to the receiving firm the client ID information which is required in the transaction report that the executing firm should send to its competent authority.
 - Requiring firms that do not transmit the necessary client ID information to the receiving firm to report the trade to their competent authority, including the client ID and specifying that the report is on an order transmitted to the respective firm.
111. The first option would have the advantage of not creating new reporting obligations for any firm or Member State. On the downside, it is unlikely that firms in certain Member States would agree to pass on client details due to legitimate commercial interests. Client codes can be almost anonymous (internal codes at firm's level) in some reporting regimes but could allow for clear identification of the client in others (tax payer number, name/surname). It is noted also that where the client ID is assigned at investment firm level, it may be necessary for the transmitting firm to pass an additional identifier to the executing firm to ensure that the competent authority can identify the investment firm that assigned the code to the client.
112. The second option carries the merit of protecting the client information from the receiving firm but has the disadvantage that it would require new reporting obligations for those firms (the transmitting firms) in most countries. This could entail some reporting duplication since execution of those orders would also be reported by the executing firm (for instance, the firm that faces the market or platform). However, as long as the reporting of these transmissions is clearly marked as such, there should be workable solutions to avoid double counting and distinguish these reports at the supervisor level.
113. Since both solutions would reach the same goal from a supervisory point of view, it could be left to the choice of the firms to either pass on the client ID information or assume the obligation to report the trade to the CA themselves (or through the other methods allowed by MiFID). This would accommodate different reporting rules existing across the EU, taking into account that client ID codes, as long as there is no single pan-European one, can contain more sensitive information in some jurisdictions than in others. It would also have the advantage of allowing

firms to decide depending on the nature of the receiving firm and their commercial interests (for instance, firms that pass an order for execution to another firm in the same group may want to pass the client information onwards for the executing firm to do the reporting to the supervisor).

114. Since the decision to require to transmit the client ID to the receiving firm or to report the trade to the CA would depend on the final coding structure of client identifiers to be adopted at national level, each Member State could be given the ability to allow the options described above for the firms in its jurisdiction or just one of the alternatives, in case the structure of client identifiers makes the other one not advisable or not workable. While CESR considers that the firms could have the choice, there may be cases where due to national circumstances, one alternative is preferable.

Proposal

115. CESR suggests amending MiFID to require that Member States ensure that, when orders are transmitted for execution, the transmitting firm either:

- Transmits the client ID to the receiving firm; or
- Reports the trade to the Competent Authority with a mark that differentiates it from ordinary executions, including full client ID, to the CA

6 TRANSACTION REPORTING BY MARKET MEMBERS NOT AUTHORISED AS INVESTMENT FIRMS

116. Article 2(1)(d) of MiFID provides that the Directive does not apply to persons who do not provide any investment services or activities other than dealing on own account unless they are market makers or deal on own account outside a regulated market or an MTF on an organised, frequent and systematic basis by providing a system accessible to third parties in order to engage in dealings with them.
117. The above exemption could potentially create a situation where firms not authorised as investment firms under MiFID fall outside the obligation to report transactions to the competent authority as provided under Article 25(3) of MiFID while trading in financial instruments admitted to trading on regulated markets also when such firms are members of regulated markets or MTFs.
118. Trades conducted by such firms on the regulated market's or MTF's order book contribute to the price formation process for the regulated market or MTF involved. The lack of reporting obligation raises serious concerns in such circumstances as it undermines the general concept of market monitoring and supervision system based on transaction reporting.
119. Reporting of those trades could be done by the members who conducted them but since these are firms exempted from the application of the directive as a whole, this could turn problematic. First, applying MiFID as a whole to such firms is not an option, since it would be disproportionate. Second, lifting partially the MiFID exemption for those companies, by making them subject to only certain aspects of the MiFID regime (Article 25, Article 57, relevant articles of Regulation 1287/2006, articles related to supervision and enforcement capabilities by supervisors, etc.) could prove a complex exercise.
120. Alternatively, the trades could be reported to the competent authorities by the regulated markets and MTFs where those trades were finalised. Of course, trading venues that assume that obligation should incorporate in their rules such a provision and could charge these firms the internal cost of reporting to supervisors. In this case, a specific provision should be added in MiFID. Trading venues should have a clear distinction of which of their members are investment firms and which are operating under the exemption provided in Article 2(1)(d), to be able to report on behalf of these.

Proposal



121. CESR suggests amending MiFID by introducing a transaction reporting obligation in Article 25(3) applicable to regulated markets and MTFs that admit as members undertakings currently falling under the Article 2(1)(d) exemption for all the transactions carried out by those members on the respective regulated market or MTF.