



FEEDBACK STATEMENT

**CESR Technical Advice to the
European Commission in the
Context of the MiFID Review-
Standardisation and
Organised Platform Trading of
OTC Derivatives**



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Executive summary

Standardisation

In order to further the objectives of the G20, in relation to the promotion of an efficient and sound derivatives market, CESR considers that the current situation is unsatisfactory and proposes that steps should be taken to increase the proportion of over-the-counter (OTC) derivatives being standardised by asset class.

CESR believes that a higher level of legal, operational and product standardisation (including increased use of electronic confirmation systems) can be achieved and would be beneficial for operational efficiency and the reduction of systemic risk. This should be achieved through the development of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described below.

Legal, process and product standardisation

CESR agrees that market participants should develop further legal and product standardisation and more automated processes and does not recommend at this stage mandating the use of electronic confirmation systems, understood as 100% electronically confirmed contracts, but ambitious targets should be set for an increased and high level of standardisation and electronic confirmations in order to achieve a higher level of straight-through processing.

CESR is also of the view that European regulators, with appropriate involvement by ESMA, should be strongly involved in international fora where such issues are discussed to ensure consistency of approaches and level playing field.

Calibration and monitoring of industry targets

It is proposed to launch a process to set targets by asset class for increased legal, process and product standardisation, and to make arrangements to monitor the achievement of the targets.

Measurement and Further Action

The core principles of the objectives pursued and the approach taken by regulators to promote standardisation of OTC derivatives should be set in regulatory measures.

In case the targets were not met, appropriate mandatory regulatory intervention should be adopted by ESMA (in conjunction with EEA national regulators) to lead to their achievement by the industry.

Trading on organised platforms

In relation to trading on venues offering an organised trading environment (referred to in the consultation paper as “exchange trading” and in this advice as “organised trading venues”) CESR understands that current situation is unsatisfactory and believes that trading of standardised derivative products on organised trading venues is to be incentivised by regulators, even though not mandated at this stage.

Nature of Proposed Regulatory Action

It is proposed that this action takes the form of carefully defined industry targets, with arrangements to monitor their achievement by the industry. In case the targets were not met, appropriate mandatory regulatory action should be adopted by ESMA (in conjunction with EEA national regulators) to ensure their achievement by the industry.



The minimum characteristics necessary for a platform to qualify as an Organised Trading Venue

CESR considers that further work is necessary in order to define the term “organised trading venue” in this context and determine the range of characteristics that a derivatives venue should possess, so as to qualify as an organised trading venue and meet the objectives set forth by the G20. CESR recommends that such work be initiated as soon as possible and stands ready to assist the Commission in this regard.

In CESR’s view, it is clear that the characteristics of market transparency and operational efficiency are, as a minimum, necessary to meet the G20 objectives. In addition, CESR considers that it may be necessary to incorporate further functional characteristics into the definition of an organised trading venue, based on a fuller assessment of their role in furthering the G20 objectives. Such characteristics may include some or all of the following:

- easy and non-discriminatory market access
- non-discretionary and transparent rules
- objective criteria for the efficient execution of orders
- multi-laterality
- authorisation/regulation and monitoring by competent authorities
- operational resilience; and
- surveillance of compliance with the organised trading venue’s rules.

As an initial conclusion, it is clear that trading platforms regulated as Regulated Markets and MTFs meet the full range of functional characteristics described above and, accordingly, unequivocally meet the objectives of the G20.

In legislative terms, the key objective of CESR’s further work should be to determine whether other trading platforms, in addition to RMs and MTFs, meeting all or part of the criteria set out above, may qualify as organised trading venues.

If a concept beyond the RM and MTF definitions was necessary, it is clear in CESR’s view that the equities-focused regimes for systematic internalisers and broker crossing systems would not be appropriate as currently formulated.

Eligibility of products for Organised Trading Venues

It is proposed that, in order for a derivative product to be deemed eligible for trading on an organised trading venue, a number of pre-conditions must be satisfied. These are:

- a) The derivative contract is standardised from the product, legal and process point of view; and
- b) The market for the derivative contract is sufficiently liquid.

A derivative product which meets these pre-conditions is referred to in this paper as an “Eligible Derivative”.

A derivative product already traded on a RM or an MTF should be presumed to be an Eligible Derivative (a minimum period of trading on a RM could be considered), unless in ESMA’s judgement specific circumstances, such as a lack of liquidity in a RM/MTF-traded product, make this inappropriate.

Regarding bespoke contracts for non-financial-institutions with specific hedging needs, these are not covered by the “standardised derivatives” scope of CESR’s present work.



The calibration and monitoring of industry targets

In order to effectively design, implement and oversee a system of targets, CESR proposes that ESMA be appointed to fulfil these functions. ESMA's responsibilities would include:

- (a) The determination of the Eligible Derivatives covered by the targets.
- (b) The determination of the targets and in particular the proportion of business in Eligible Derivatives that should take place on organised trading venues over a specified period of time (expressed as a percentage of total business by relevant participants in Eligible Derivatives over the same period of time).

When calibrating those targets, the following general principles should be applied:

- The targets should be set at a sufficiently ambitious premium to these existing levels in order to effectively encourage increased platform trading;
- The targets should allow market participants to trade in Eligible Products on an OTC basis in specific circumstances such as non-addressable liquidity and non price-forming transactions;
- The targets should be drawn up in consultation with the industry; and
- Where appropriate, the targets should be differentiated by asset class.

- (c) The publication of the targets on the basis of determined objective criteria. ESMA should also have discretion to publish a general statement, at an appropriate juncture, regarding the compliance or non-compliance of the industry with the targets.

Measurement and further action

The core principles of the objectives pursued and the approach taken by regulators to incentivise trading of standardised OTC derivatives on organised venues should be set in regulatory measures.

In case the targets were not met, appropriate mandatory regulatory intervention should be adopted by ESMA (in conjunction with EEA national regulators) to lead to their achievement by the industry.

This Feedback Statement provides feedback to the views expressed by respondents to CESR's Consultation Paper on Standardisation and Exchange Trading of OTC Derivatives (Ref. CESR/10-610; from now on, the CP) and should be read in connection with the CP and CESR Technical Advice to the European Commission in the Context of the MiFID Review- Standardisation and Organised Platform Trading of OTC Derivatives (Ref. CESR/10-1096).

1. A PRELIMINARY STEP ON THE WAY TO ORGANISED PLATFORM TRADING: STANDARDISATION



Background

1. There are three elements to be considered in relation to standardisation:
 - a. Legal/contract uniformity: this includes standard transaction documentation and definitions;
 - b. Process uniformity (automation): this includes straight-through-processing, matching, confirmation, settlement and event handling;
 - c. Product uniformity: including standard valuation, payment structures and dates.
2. In the consultation paper (Ref. CESR/10-610, from now on, the CP), CESR recognised that legal/contract uniformity is the driver to achieving other elements of standardisation and acknowledged that there seemed to be widespread adoption of standard legal definitions and documents in the market. Nevertheless CESR remained keen to understand whether more needs to be done in this area, especially with a view to achieving other elements of standardisation.
3. To that end, the CP discussed the benefits and possible limitations of standardisation together with an assessment of the current degree of standardisation in the OTC derivatives markets. CESR considered the views of market participants in its assessment of the degree of standardisation.
4. CESR also recognised in the CP that bespoke OTC derivatives are often used for hedging purposes by non-financial firms and, as a result, CESR expressed the preliminary view that firms should be able to retain the flexibility to customise aspects such as standard valuation, payment structures, payment dates, and so forth for OTC derivative transactions. However, it was considered that this possibility needs to be carefully balanced against the benefits that adoption of straight-through processing and other automated confirmation systems can deliver. CESR was therefore eager to explore what measures could be taken to foster a higher degree of product standardisation based on the firm belief that a wider use of electronic post-trade processes would enhance the resilience of the market.
5. CESR expressed the preliminary view that greater standardisation of OTC derivatives contracts can deliver efficiency benefits to the market, but recognised the role that bespoke products can play in this context.
6. CESR acknowledged the significant progresses made by the industry towards an intensified use of electronic confirmation systems, but considered that there is - depending on the asset class - significant room for further improvement in this area. CESR was therefore considering recommending to the European Commission that it take regulatory action so as to make the use of electronic confirmation systems mandatory.
7. As part of this assessment CESR considered the most appropriate way in which a mandatory requirement might be applied. In doing so CESR committed to take into account the cost implications for all participants and in particular for smaller participants.
8. In the CP, CESR asked the following questions:

Q1: Do you agree with CESR's assessment of the degree of standardisation of OTC derivatives? Is there any other element that CESR should take into account?
9. 39 responses to this question were received.
10. In general, respondents agreed with CESR's assessment. Many respondents stressed the need to retain flexibility, e.g. for hedging purposes.



Q2: Do you agree with the benefits and limitations of standardisation noted above? Please specify. Can you also describe and, where possible, quantify the potential impact of the limitations to standardisation? Are there any other elements that should be considered?

11. 41 responses to this question were received.
12. There was a broad agreement on the benefits and limitations. Several responses highlighted the need for flexibility and thus non-standardised contracts. It was also mentioned that the benefits and limitations should be considered with respect to each of the asset classes individually.

Q3: Do you agree that greater standardisation is desirable? What should be the goal of standardisation?

13. 42 responses to this question were received.
14. Regarding the question on the desirability of greater standardisation and the goals of standardisation, there was almost unanimous support to legal and process standardisation, but respondents did not see a need for further product standardisation. Many respondents stressed that product standardisation should be driven by market needs and priorities. They also indicated that standardisation should not be a goal in itself.
15. Various goals of standardisation were mentioned such as: to increase market efficiency, to reduce legal and operational risks, to increase pre-trade transparency, to increase post-trade efficiency, to reduce systemic risks and to ensure adequate protection for investors.

Q4: How can the industry and regulators continue to work together to build on existing initiatives and accelerate their impact?

16. 37 responses to this question were received.
17. As regards the question on how the industry and regulators can continue to work together, the industry commitment letters agreed by the OTC Derivatives Supervisors Group (the ODSG group) with market participants were mentioned in many responses. Some responses suggested that the approach taken by EU regulators should build on the existing initiatives or consultations, joint working groups and other forms of partnership. Legislation was not seen by many respondents as an effective way forward because of possible unintended negative consequences.

Q5: Are there any obstacles to standardisation that could be removed by regulatory action? Please elaborate.

18. 34 responses to this question were received.
19. When commenting on obstacles to standardisation that could be removed by regulatory action, some respondents indicated that regulatory action would not help to remove obstacles. Standardisation should be a market led process in their opinion. Other respondents pointed out accounting rules, overlapping and conflicting regulation, legal and fiscal differences between jurisdictions as examples where regulatory action could be helpful.

Q6: Should regulators prioritise focus on a) a certain element of standardisation and/or b) a certain asset class? Please provide supporting rationale.

20. 37 responses to this question were received.



21. Several respondents suggested prioritising certain asset classes (like CDS, fixed income and foreign exchange forwards) that were considered as most important for the stability and functioning of the markets or from a systemic point of view, whereas others suggested to focus on asset classes for which standardisation is readily achievable. Also prioritisation of legal and process standardisation was mentioned.

Q7: CESR is exploring recommending to the European Commission the mandatory use of electronic confirmation systems. What are the one-off and ongoing costs of such a proposal? Please quantify your cost estimate.

22. 42 responses to this question were received.
23. A large majority of respondents supported the use of electronic confirmation systems in general, but were opposed to their mandatory use. In these participants' opinion, the costs may be prohibitive for smaller market participants (or market participants who trade OTC derivatives infrequently). Mandatory action was seen as neither desirable nor practicable and was considered to lead to increased costs for all market participants. There was a general agreement that this should be a market-driven development. Almost all respondents indicated that it is difficult to give a quantification of the cost estimate of implementing electronic confirmation systems, but for these respondents costs were expected to be higher than the benefits delivered by it.

CESR view

24. CESR considers that the current situation is still unsatisfactory, although it acknowledges the progress made by the industry towards further standardisation. At the same time, CESR agrees with market participants that, at least at this stage, the industry should have the ability to develop the specific systems to achieve further standardisation. However, it considers that there is a role to be played by regulators in this regard which is ensuring that further effective progress is made within a reasonable timeframe.
25. In particular, CESR has taken account of the responses received to the CP, especially on the following points:
 - a. The request for a cautious approach regarding regulatory mandatory involvement in further standardisation;
 - b. The positive assessment made by the respondents of existing international initiatives.
 - c. The need to explore additional barriers to standardisation that might not be evident, such as legal, accounting and tax barriers.
26. Taking into account the comments received, and in order to further the objectives of the G20, in relation to the promotion of an efficient and sound derivatives market, CESR proposed that steps should be taken to increase the proportion of OTC derivatives being standardised by asset class.
27. This should be achieved through the development of carefully defined industry targets, with arrangements to monitor the achievement of the targets.
28. The level of the targets needs to be calibrated by asset class, and the scope of the targets defined by reference to the range of firms/institutions that it is desirable to cover. Regulators need to be involved in the process to provide the framework for discussion, set appropriate targets and monitor their achievement. Therefore, CESR recommends the following policy approach taking into account the comments received in the consultation and the regulatory needs identified.

Legal, process and product standardisation



29. Despite the comments received against product standardisation, CESR still believes that a higher level of legal, operational and product standardisation (including increased use of electronic confirmation systems) can be achieved and would be beneficial for operational efficiency and the reduction of systemic risk. This should be achieved through the development of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described below.
30. CESR agrees that market participants should develop further legal and product standardisation and more automated processes. Acknowledging the response to the consultation, CESR does not recommend mandating the use of electronic confirmation systems, understood as 100% electronically confirmed contracts. However, ambitious targets should be set for an increased and high level of standardisation and electronic confirmations in order to achieve a higher level of straight-through processing.
31. CESR feels that European regulators, with appropriate involvement by ESMA should take part in other global initiatives under way as this would help make significant progress, and that EU authorities should also collaborate closely on their contributions.

Calibration and monitoring of industry targets

32. Therefore, CESR proposes to launch a process to set targets by asset class for increased legal, process and product standardisation, and to make arrangements to monitor the achievement of the targets. In case the targets set out were not met, appropriate mandatory regulatory action to lead to the achievement of the targets should be initiated.
33. CESR proposes that ESMA, on an EEA level, should have the following tasks building on work of other international initiatives:
 - i) Analyse legal barriers to legal and process standardisation as mentioned by respondents to the consultation (e.g. legal, accounting, tax barriers);
 - ii) Develop and set appropriate targets for legal, process (including electronic confirmation) and product standardisation levels per asset class, in consultation with the industry, recognising that in relation to product standardisation there is a balance to be struck between allowing a role for bespoke products for purposes of hedging risk and increased product standardisation for operational efficiency purposes. ESMA should determine the targets to be met, deadlines and deliveries in a transparent manner;
 - iii) Define the scope of the targets by reference to the desired range of firms/institutions and agree on targets with relevant OTC derivatives market participants;
 - iv) Monitor the achievements reached by market participants against the agreed targets;
 - v) Monitor the level of standardisation vs. the level of trading in non-standardised products; and
 - vi) Have the power to decide on the publication of the targets achieved.
34. At this stage, CESR does not have a definitive view on the exact targets that should be reached in each asset class nor on the range of firms/institutions that should be covered. However, CESR considers that a sufficiently ambitious approach should be adopted, taking into account the scope of other EU and international measures in relation to OTC derivatives, to ensure that the proportion of standardised OTC derivatives increases.

Measurement and further action



35. The core principles of the objectives pursued and the approach taken by regulators to promote standardisation of OTC derivatives should be set in regulatory measures.
36. On that basis, ESMA would then determine the specific targets to be met. It is proposed that the measurement of compliance with industry targets could be performed using data from various sources, including data obtained from trade repositories, when such data becomes available.
37. In case the targets were not met, appropriate mandatory regulatory intervention should be adopted by ESMA (in conjunction with EEA national regulators) to lead to their achievement by the industry.

2. ORGANISED PLATFORM TRADING

Background

38. In the second part of the CP, CESR considered issues related to the trading of OTC derivatives on organised trading platforms. It included an assessment of the current degree of organised platform trading of standardised OTC derivatives, a part exploring the benefits and drawbacks of 'organised trading' of standardised OTC derivatives, consideration of the characteristics and the level of standardisation necessary in order for a derivative product to be eligible for organised platform trading, an analysis of the concept of 'trading on organised markets' in the EU legislative context and an assessment of existing market-led and regulatory initiatives promoting organised trading of OTC derivatives.
39. CESR consulted its view that trading on 'organised markets' could deliver a number of benefits such as improved price formation, a higher level of transparency, enhanced liquidity, greater operational efficiency and easy access for market participants. There are however also a number of pre-requisites to organised platform trading of derivatives that may explain why the OTC segment of the market remains very large such as the need for the contracts to be standardised. As a preliminary opinion, CESR stated in the CP that it favoured incentivising the increased use of 'organised trading venues' but also mentioned that it continued to consider whether mandatory usage is desirable, taking into account the discussions currently taking place on this issue in other jurisdictions and international fora. CESR also expressed the will to further explore with market participants which kind of incentives could effectively promote organised platform trading.
40. Immediately after the CP was published, the Dodd-Frank Act was passed where the concept of 'swap execution facility' (SEF) appeared for "trading systems or platforms in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that (A) facilitates the execution of swaps between persons; and (B) is not a designated contract market." In practice, the types of platforms that fulfil these criteria will have to be further determined by the US authorities (SEC and CFTC).

Benefits and limitations of organised platform trading

41. In particular, CESR asked in the CP the following questions:
Q8: Do you agree with the assessment done by CESR on the benefits and limitations of exchange trading of OTC derivatives? Should any other parameters be taken into account?
42. 44 responses to this question were received.

43. The vast majority of respondents agreed at least broadly with the assessment done by CESR. However, there was disagreement on some particular issues. Whereas the majority of respondents confirmed CESR's view that room for innovation may be reduced by mandated exchange trading, a smaller number of market participants held the opposite view, stressing the innovative power of exchanges. A considerable number of market participants stated that the goal of price transparency can also be achieved by single-dealer and multi-dealer platforms. In this context it was often suggested that (post-trade) transparency could also be organised in the OTC space. Regarding effects on liquidity there were again different but quite evenly split views, some warning of a decrease in liquidity resulting from too much transparency, while others saw no danger at all of excessive transparency affecting liquidity.
44. A high number of respondents pointed out that mandatory exchange trading for all products would not be consistent with participants' needs, as a need for bespoke products and alternative trading facilities was seen. With regard to classic exchange trading a few respondents complained about constraints such as trading hours, membership and costs. For non-financials the potential margin requirements associated with exchange trading and central clearing were viewed negatively.
45. Finally, a number of respondents suggested that a more thorough analysis would be necessary before exchange trading were mandated.
46. As regards the benefits of regulatory action to mandate trading of standardised OTC derivatives on organised trading venues, a number of responses to Q8 of the CP provided views on the eventual benefits of a mandatory regulatory action towards greater trading of OTC derivatives on organised venues. For consistency reasons, the summary of the responses received is included with the responses to Q28.

Q9: Which sectors of the market would benefit from/be suitable for (more) exchange trading?

47. 44 responses to this question were received. 19 were in favour of more exchange trading in suitable sectors and identified particular instruments in this respect. 8 were against more exchange trading or saw considerable difficulties to identify suitable market segments in this regard. The rest of responses were either indifferent or did not make any specific proposals.
48. Responding to the question on which sectors of the market would benefit from and/or be suitable for (more) organised platform trading, the following market sectors/asset classes were identified as suitable for more organised platform trading: equity, (single-name and index) CDS contracts, plain vanilla credit/interest rate swaps and equity futures, on-the-run credit indices, ABX indices, currency derivatives, swaptions, variance swaps, plain vanilla long options. In more general terms it was suggested that products would be especially suitable where they are highly standardised, high in volume and eligible for CCP clearing. However, it was also pointed out that instruments with a lower level of standardisation may also be platform traded and that standardisation is only one factor among others determining the feasibility of organised platform trading.

Q10: In your view, for which sectors of the market will increased transparency associated with exchange trading increase liquidity and for which sectors will it decrease liquidity? Please specify.

49. 44 responses to this question were received. 14 respondents clearly saw benefits from increased transparency in terms of liquidity at least for some sectors of the market. 14 respondents identified at least potential drawbacks from too much transparency, while the rest of respondents either had not a formed view or suggested a deeper analysis.
50. On one end of the spectrum respondents were of the view that all sectors of the market would benefit in terms of liquidity, while on the other end of the spectrum it was put forward that

transparency would not have any (significant) effect on liquidity and could be even harmful, for example in markets with large and sporadic transactions. With regard to a potential decrease in liquidity CDS and interest rate derivatives markets were mentioned, while others expressly saw benefits for these markets and additionally also for energy markets. Some more general remarks were that standardised products would benefit from increased transparency, but the exact degree of transparency would need to be calibrated carefully in order to achieve a balance between trading confidentiality, liquidity and price transparency for end-users. More than once it was suggested that trade repositories could serve to enhance post-trade transparency.

Q11: Do you identify any other elements that would prevent additional OTC derivatives to be traded on organised platforms?

51. 44 responses to this question were received. From the responses received, only 9 respondents did not identify any additional elements.
52. The following elements preventing additional platform trading of OTC derivatives were mentioned: need for bespoke products for hedging purposes, end-users wishes for flexibility, dealers' unwillingness to be transparent (so called vested interests), margin requirements for certain client sectors, lack of interest from corporate and end-users, amount of required legal documentation, advantages of voice broking, potential prospectus requirements, lack of incentives, listing costs, too little liquidity.

Q12: How should the level of liquidity necessary/relevant to exchange trading be measured?

53. 44 responses to this question were received.
54. Several parameters with regard to measuring the level of liquidity necessary for exchange trading were suggested: number of the existing and potential new participants in the OTC derivative in question, number of active traders, size per trade, BIS OTC data, size of bid-offer spread, market depth, number of limit orders, notional traded/turnover, open interest, resiliency, volatility, ADT compared to underlying asset equivalent, replacement cost of position, average frequency of trading and ratio of participants to instruments. A number of times it was expressed that the determination of a suitable liquidity level is difficult if not impossible; a thorough consultation process was proposed.

Assessment of characteristics/level of standardisation that OTC derivatives have to meet to be considered eligible for trading on an organised trading platform

55. After a high-level assessment of the characteristics and level of standardisation needed for an OTC derivative contract to be eligible for trading on an organised trading platform, CESR concluded that the cornerstone for eligibility for trading on an organised trading platform is a high degree of the three elements of standardisation (legal standardisation; process standardisation; and product standardisation). However, it requested the views of market participants on other additional factors that might be necessary to consider, such as the size of the underlying market, the size and diversity of market, liquidity, availability of CCP clearing or contract fungibility.
56. In order to better understand what additional factors need to be in place to achieve a higher degree of derivatives traded on organised trading venues, CESR asked the following questions:

Q13: Do you agree with CESR's assessment of the characteristics and level of standardisation which are needed for a contract to be traded on an organised trading platform?



57. 44 responses to this question were received. 24 respondents agreed with CESR's assessment, 8 disagreed or had significantly different views on particular issues while the remaining part did not give a clear view.

58. In general there was broad agreement on CESR's assessment of the level of standardisation necessary for organised platform trading. However, it was pointed out by a number of respondents that also instruments with a lower level of standardisation may be platform traded and that standardisation is only one factor among others determining the feasibility of organised platform trading.

Q14: Is the availability of CCP clearing an essential pre-determining factor for a derivative contract to be traded on an organised trading platform? Please provide supporting rationale.

59. 44 responses to this question were received.

60. The majority of respondents believed that CCP clearing availability is not an absolutely necessary precondition for exchange or exchange-like trading, but acknowledged that there is a strong practical inter-linkage between the two.

Q15: Is contract fungibility necessary in order for a derivative contract to be traded on an organised trading platform? If so, which factors would be necessary to achieve full fungibility, not only within the same market but across different execution venues? Please provide supporting rationale.

61. 41 responses to this question were received.

62. Respondents' views were split as regards the issue of fungibility as a prerequisite for the exchange trading.

63. Almost half of the respondents thought that fungibility is necessary for exchange trading. Some argued that only fungible contracts can concentrate liquidity. According to others, fungibility is needed for anonymous trading and allows for netting which exchanges must provide as added value for market participants.

64. Other respondents thought that non-fungible contracts may be traded on organised platforms. Some respondents pointed to the fact that derivatives are bilateral contracts, so as they are not exchangeable with contracts concluded between different parties. Several respondents considered that fungible contracts are necessary only for order-book trading and are not necessary if the platform allows for bilateral negotiation. It was also mentioned that fungibility is necessary only if there is number of participants with similar trading patterns to successfully employ netting.

65. As regards the fungibility across different execution venues, only limited number of respondents provided their comments. Many of them highlighted the advantages that such fungibility would have on the reduction of risk between different products. On the other hand, some did not see fungibility desirable, because the link between clearing houses increases systemic risk for the market as a whole. In other respondents' view, the current lack of interoperability between the infrastructure providers creates commercial disincentive for the use of exchanges. Some respondents underlined that the most important factor to achieve fungibility across different execution venues is that legal terms should all be the same.

Q16: Which derivative contracts which are currently traded OTC could be traded on an organised trading platform? Please provide supporting rationale.

66. 31 responses to this question were received.

67. Several respondents expressed the view that any derivative or a broad range of derivatives could be traded on exchange, if they are sufficiently standardised and/or liquid, are eligible for CCP clearing, are benchmark contracts or bear same characteristics as exchange traded products.
68. Other respondents more specifically identified contracts suitable for exchange trading. Most frequently cited contracts were index CDS and some IRS. These contracts are highly standardised and their trading could enhance liquidity and efficiency of the markets. In the case of IRS, particular products suitable for further standardisation would need to be chosen to enable their exchange trading.
69. Individual respondents also mentioned some of other derivative products such as plain vanilla swaps, forward swaps, swaptions, plain equity options and equity forwards, variance swaps, ABX indices, currency basis swaps, cross-currency swaps, commodity swaps, European and Asian call and put options on energy, base metal and precious metal, forex call and put options and FX forward.
70. Some respondents stressed that it would require extensive analysis and dialogue with market participants to determine which contracts are suitable for exchange trading.
71. Many respondents reiterated their view that organised trading should not be mandated, but that market participants should be left to decide which execution method was most suitable. These respondents frequently pointed to the natural evolution of trading in trading methods which already is in place in the market. CDS, as an example of that evolution, has started to be traded electronically well before the crisis.

Q17: Please identify the derivative contracts which do trade on an organised trading platform but only to a limited degree and could be traded more widely on these types of venues.

72. 21 responses were received.
73. Many respondents expressed the idea that markets naturally gravitate towards the execution methods which best suit them, and natural change to electronic execution appears where appropriate. Wider trading depends on increased on-exchange demand and liquidity. One of the reasons for OTC trading may be related to execution costs applied by organized venues.
74. Other respondents more specifically outlined contracts where exchange trading could be enhanced. These derivatives were again (see Q16) CDS and IRS, because the use of organized trading platforms for such instruments has already started. There is a high level of legal and product uniformity of these products. Trading in these instruments could be extended to more participants, if post-trade processing is eased. Other contracts mentioned are equity derivatives that were traded OTC, while similar plain vanilla contracts are traded on exchanges.

Concept of “exchange trading” in the context of OTC derivatives

75. In line with the G20 agreement of September 2009, where it was considered that “all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate”, the European Commission Communication dated 20 October 2009 set out some of the aspects of organised trading that might add value to central clearing (i.e. multilateral trading systems; pre- and post-trade transparency, to provide high visibility to prices, volumes and open interests; and easy market access). CESR’s consultation paper listed some additional characteristics applicable to certain organised venues under MiFID (non-discretionary and transparent rules; objective criteria for the efficient execution of

orders, authorisation/regulation and monitoring by competent authorities, operational resilience and surveillance of compliance with the organised trading venue's rules).

76. In its CP, CESR made an attempt to evaluate what kind of trading platforms would meet the Commission's goals and how this may translate into the EU legal environment and the MiFID context. The bilateral/multilateral aspect of the transaction was particularly analysed in the context of the price formation process. If MiFID was taken as a model, there are only three possible execution venues to be considered: regulated markets (RMs), multilateral trading facilities (MTFs) and systematic internalisers (SIs). Apart from that, CESR had recommended in its Technical Advice to the European Commission in the Context of the MiFID Review-Equity Markets (Ref. CESR/10-802) that a new regulatory regime with tailored additional obligations be introduced for investment firms operating broker crossing networks (BCS). In that context, it was explained that MiFID defines RMs and MTFs as "multilateral systems operated and/or managed by a market operator, which bring together or facilitate the bringing together of multiple third-party buying and selling interests" (Article 4(1)(14) and (15) of MiFID) as opposed to bilateral systems where an investment firm enters into every trade on its own account and not as a riskless counterparty interposed between the buyer and the seller (Recital 6 of MiFID). It was noted as well that, MiFID currently treats RMs, MTFs and systematic internalisers (SIs) as trading venues.
77. As a consequence, the CP stated that one of the key elements of future CESR advice was to discover whether there is a role to be played by single-dealer platforms that make firm quotes and pricing information available to all participants. Therefore, CESR asked whether a trading venue might also be considered to fulfil the requirement of being a multilateral trading system on the basis of its ability to make pricing information (both pre- and post-trade) available on a multilateral basis.
78. In line with that, CESR asked the questions below:
- Q18: In the OTC derivatives context, should any regulatory action expand the concept of "exchange trading" to encompass the requirements set out in paragraph 86 and 87 or only the requirements set out in paragraph 86? Please elaborate.**
79. 35 responses to this question were received.
80. A majority of respondents were opposed to regulatory action that would have the effect of limiting participants' ability to trade derivatives products on platforms that did not meet the requirements of paragraph 86, or paragraphs 86 and 87, despite perhaps being best suited to their current needs. These respondents called for the definition of an organised trading platform to be cast as wide as possible to allow the maximum flexibility for the market to gravitate towards the execution method most suited to it. OTC derivatives could benefit from a similar interpretation of the concept of "organised trading" as currently enshrined in MiFID, which reflects concepts for additional types of trading platform¹. It was stated that mandating or forcing trading on platforms that meet all the requirements would be likely to significantly damage many product markets. In the market environment, alternative trading models, such as communication networks streaming indicative prices by dealers to clients had been developed which are successful.
81. As regards the requirements of 'organised trading venues' several respondents were of the view that only platforms meeting all the requirements listed would be in a position to meet the goal of improving the stability and efficiency of the market. Some of these respondents claimed that the same rules should apply for the same trading model, and that the application of the requirements in paragraph 86 only would lead to an unlevel playing field.

¹ Systematic internaliser and a new concept of broker crossing system, according to CESR Advice to the European Commission in the context of the MiFID Review- Equity Markets (Ref. CESR/10-802).

Other respondents stressed that these requirements accomplish a fairer and non discriminatory access to derivative trading.

82. One respondent did specifically disagree with a multilateral character of the market. In its view, multilateral market may impact risk associated with provision of liquidity to markets. Other respondents elaborated that benefits of multilateral systems appear only in certain cases, not generally. In this view, a multilateral system is not suitable for derivatives because of the bilateral character of contracts and little use of transparency information which disregard counterparty risk.

Q19: Do current trading models and/or electronic trading platforms for OTC derivatives have the ability to make pricing information (both pre- and post-trade) available on a multilateral basis? Please provide examples, including specific features of these models/platforms.

83. 30 responses to this question were received.
84. Many respondents thought that there is already pricing information available in the trading platforms: pre-trade information is already made widely available, whereas the post-trade information is provided to a much lesser extent. Technically, there was not seen any substantial problem to make pricing information public on a multilateral basis. In particular, some respondents stated that any electronically operated trading platform should be technically able to make pricing information public and/or available on a multilateral basis, and that even telephone brokerage could contribute to public availability of pricing information. However, some respondents expressed the view that only regulated markets and MTFs can provide pricing information on multilateral basis, meeting the G20 objectives and in particular, improving transparency in the derivatives markets.
85. There seemed to be agreement on considering that optimal transparency is possible in a fragmented market, on the basis of the data provided by electronic trading platforms. Equity transparency under MiFID was put as an example. However, several respondents argued that showing post-trade information on multilateral basis can expose market participants to gaming from others and is therefore not desirable.

Systematic internalisers

86. Systematic internalisers (SI) are defined by MiFID as “investment firms which, on an organised, frequent and systematic basis, deal on own account by executing client orders outside a regulated market or an MTF”². They undertake bilateral transactions.
87. The investment firms performing the activity of systematic internalisers in shares are subject to specific and limited pre-trade transparency requirements: for liquid shares, they have to publish firm bid or offer quotes for sizes up to standard market size with no minimum size³.
88. In addition, the activity of internalisation has to be performed according to non-discretionary rules and procedures⁴ but internalisers are not required to provide open access and have discretion as to the counterparties they wish to trade against⁵.
89. In contrast to requirements for RMs and MTFs, SI obligations are focused on the equity market and specifically on retail clients. Unlike the cash equity markets, OTC derivative markets are essentially wholesale markets. Additionally, the definition of SI for equity

² Article 4(1)(7) MiFID

³ Article 27 MiFID.

⁴ Article 21(1)(a) MiFID Implementing Regulation. See also recital (50) MiFID.

⁵ Article 21(1)(a) MiFID Implementing Regulation.



markets is being reviewed⁶, exploring whether the SI definition requires clarification and whether or not the obligations that the definition entails should be recalibrated.

90. As part of the consultation, CESR asked market participants whether, in view of existing trading practices, the systematic internaliser regime as applied to shares, was relevant for the trading of OTC derivatives. In particular, CESR asked the following questions:

Q20: Do you consider the SI-regime for shares relevant for the trading of OTC derivatives?

91. 27 responses to this question were received.

92. Respondents unanimously rejected the requirements associated with the SI-regime as relevant for the trading of OTC derivatives. They argued that the SI-regime was designed for equities, requires liquid and standardised assets and is intended for retail investors. On the contrary, the OTC derivatives market is bilateral and wholesale with the majority of bespoke, illiquid products. Even in case of equity trading, the SI-regime has not proved to be successful and is therefore subject to review. According to some respondents, it was relevant that the SI-regime lacks multilaterality and does not provide open access.

Q21: If so, do you consider that the current SI-regime provides the benefits described above which ‘exchange trading’ may offer or are amendments needed to the SI obligations to provide these benefits to the OTC derivatives market?

93. 12 responses to this question were received.

94. As explained above, respondents did not consider that the SI-regime provides the described benefits. Therefore, they suggested neither applying the SI regime to derivatives nor amendments to the SI-regime.

Crossing systems

95. CESR had recently consulted on policy initiatives to regulate crossing systems/processes, defined as “firms in the EU who operate systems that match client order flow internally”⁷. Despite CESR had only consulted on crossing networks for equity instruments, the participants’ views were requested on whether the proposed regime could be relevant for the trading of derivatives. In particular, CESR asked the following question:

Q22: Which characteristics should a crossing network regime, as envisaged in the review of MiFID, have for a crossing network to be able to be qualified as a MiFID “organised trading venue”?

96. 21 responses to this question were received.

97. Generally, respondents struggled to see how the BCN concept was relevant to the scope of organised trading venues in this context. The minority of respondents that did comment on the BCN concept suggested that BCN services should be subject to similar regulatory requirements to those applicable to other types of organised trading venue under MiFID.

Other electronic trading facilities: the US case (“swap execution facilities”)

⁶ Consultation Paper on CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets (Ref. CESR/10-394).

⁷ CESR Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets (Ref. CESR/10-802) and CESR Consultation Paper (Ref. CESR/10-394)

98. Despite it is still in the process of being fully developed, U.S. regulatory initiative in the field of derivatives markets (where alternative trading facilities are envisaged as an equivalent to on-exchange trading when they meet certain criteria and standardised swap transactions will have to be executed on a *swap execution facility* if not executed on exchange) was analysed. In particular, ‘*swap execution facilities*’ were defined by the Dodd-Frank bill as a “*facility trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by other participants that are open to multiple participants in the facility or system, through any means of interstate commerce, including any trading facility, that—*
(A) *facilitates the execution of security based swaps between persons; and*
(B) *is not a designated contract market*”⁸.
99. Due to the global nature of OTC derivative markets, CESR requested the assistance of market participants on whether the approach adopted in the EU and the US in this context might offer scope for regulatory arbitrage.
- Q23: In your view does the envisaged legislative approach in the US leave scope for regulatory arbitrage with the current EU legislative framework as provided under MiFID? Would regulatory measures taken in the EU to increase ‘exchange trading’ of OTC derivatives help to avoid regulatory arbitrage?**
100. 35 responses to this question were received.
101. As regards the question of regulatory arbitrage between the US approach and the European legal environment in terms of MiFID, respondents generally noted the uncertainty regarding the practical application of the US regulations, in light of the rule-setting responsibilities of US regulators that will be necessary to flesh out the detailed requirements (such as in relation to the types of venue that may fall within the relevant definitions). Many respondents supported a high degree of global coordination in principle, to mitigate the risk of regulatory arbitrage, but some noted that this principle has a wider application than the US/EU, as there are other potential financial centres to which liquidity may move. Some respondents indicated that EU regulators should maintain focus on the core objectives of the review of OTC markets, and the particular characteristics of the EU market structure which are different in certain respects to the US. However, regulatory and legislative developments in other jurisdictions such as the US should be taken into account by CESR to minimise the scope for regulatory arbitrage.
- Q24: The Commission has indicated that multi-laterality, pre- and post-trade transparency and easy access are key aspects of the concept of “on exchange” trading. Do you agree with CESR applying these criteria in its further analysis of what this means in the EU context, in particular in applying MiFID to derivatives trading?**
102. 35 responses to this question were received.
103. Many respondents agreed that the criteria described in the question provide an appropriate starting point for further analysis. However, in the context that many respondents disagreed with the prospect of regulatory action, these respondents believed that any criteria used to develop the concept of “exchange trading” for the purposes of any regulatory action should be framed as broadly as possible to reflect the particular market structure, which includes a wide spectrum of execution models (voice/electronic, bilateral/multilateral) each serving important and complementary purposes. Some noted that a potential benefit of ‘exchange trading’, namely the provision of pre/post trade transparency, is likely to be delivered via the MiFID review without requiring ‘exchange trading’. A number of respondents suggested that

⁸ For a summary of the text approved, see <http://www.opencongress.org/bill/111-h4173/show>



the criteria should be enlarged to capture the additional requirements discussed at paragraph 87 of the CP.

Q25: If not, do you consider that MiFID requirements and obligations should be refined to cover deviating characteristics of other electronic trading facilities? Please elaborate.

104. 22 responses to this question were received.

105. Many respondents linked this question to the issue of mandating/incentivising exchange trading and suggested that refinement would only be necessary if there was a desire to limit trading to particular platforms. A number of respondents referred to earlier responses which emphasised the spectrum of execution possibilities within the market structure and the importance of this choice. Some respondents made a reference to paragraph 87 of the CP as additional characteristics that should be taken into account.

Assessment of existing market-led and regulatory initiatives promoting exchange trading

106. In September 2009, G20 Leaders agreed in Pittsburgh that all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012. Accordingly, the progress made to achieve implementation of these objectives, including the industry efforts to meet commitments made to supervisors, was considered in the CP.

107. Among them, the CP highlighted a working group led by the Committee on Payment and Settlement Systems (CPSS), IOSCO and the European Commission (EC) formed to assess and set out policy options for promoting increased use of standardised products and for developing a clear process to implement at the global level mandatory clearing and exchange or electronic trading requirements. Many areas of its scope were coincident to those of CESR's work, such as product standardisation, clearing-eligibility and electronic-trading-eligibility, the relationship between product standardisation and policy objectives, and analysis of how policies to incentivise a shift to clearing of standardised products may be consistently implemented at the global level.

108. CESR acknowledged the value of these initiatives and requested information from market participants of other work streams that might be taking place in the same area. Specifically, CESR asked the following question:

Q26: Are there any market-led initiatives promoting 'exchange trading' that the regulators should be aware of?

109. 29 responses to this question were received.

110. A number of respondents suggested that platform providers already have commercial incentives to continuously develop their offerings to meet user demand.

Preliminary conclusions: assessment and policy views on "exchange trading"

111. In the CP, CESR tabled as preliminary conclusions that:

- a. Exchange trading offers a number of benefits that address the concerns raised by the financial crisis and that fulfil the objectives determined by governments at global level within the G20: transparency that prevents information asymmetry and provides efficiency in the price formation mechanism/process. It also lowers systemic risk by *in fine* enabling clearing houses to get reliable pricing information and determine the liquidity of particular contracts. Furthermore, exchange trading takes



steps to prevent against market abuse through the exchanges' market surveillance schemes;

- b. Despite the clear benefits of trading OTC derivatives on organised trading platforms, bespoke contracts that are specifically built to address specific hedging concerns and that may involve the provision of specific advice and require a highly customised execution service are not suitable for trading on organised trading platforms, due to their bilateral and 'ad hoc' nature. Moreover, voice broking services are still being used and important for these 'ad hoc' transactions and electronic organised platforms would therefore not meet the needs of the industry in this respect. It is important to ensure that bespoke contracts may be designed to address the industry and corporate specific needs for risk hedging and therefore not appropriate to impose their trading on electronic organised platforms;
- c. However, since exchange trading of derivatives can deliver certain benefits, CESR is in favour of incentivising the use of organised trading venues but continues to consider whether mandatory usage is desirable, taking into account the discussions currently taking place on this issue in other jurisdictions and international fora. Thus, CESR would like to further explore with market participants which kind of incentives could effectively promote exchange trading;
- d. In order to reach the G20 and European Commission objectives, i.e. on which types of organised platforms it would be appropriate to trade sufficiently standardised OTC derivatives, CESR is considering whether these organised platforms would need to fulfil all the key criteria mentioned above (multilateral trading systems; pre- and post-trade transparency (to provide high visibility to prices, volumes and open interests); easy and non-discriminatory market access; non-discretionary and transparent rules; objective criteria for the efficient execution of orders; authorisation/regulation and monitoring by competent authorities; operational resilience and surveillance of compliance with the organised trading venue's rules) or only some of them. In any case, CESR is of the view that it would be useful that regulatory intervention promotes, supports and incentivises further trading of standardised OTC derivatives on organised platforms meeting the above mentioned criteria.

112. CESR also noted that one of the main benefits of exchange trading relates to providing market participants with helpful pre- and post-trade information and remarked the parallel work which is being undertaken by CESR on transparency for OTC derivatives.

113. In particular, CESR asked the following questions:

Q27. Which kind of incentives could, in your view, efficiently promote greater trading of standardised OTC derivatives on organised trading venues? Please elaborate.

114. 35 responses to this question were received.

115. Generally, most respondents opposed the introduction of regulator-driven incentives, as they considered that the pace of migration to platform trading should be a natural evolution led by market assessments of when products are sufficiently mature/liquid to warrant organised platform trading. Of the incentives referred to, many respondents raised the possibility of reduced capital charges for platform-traded products but generally saw a need to link this with the presence of central clearing.

Q28. Do you believe there would be benefits in a mandatory regulatory action towards greater trading of standardised OTC derivatives on organised venues? Please elaborate.

116. 42 responses to this question were received.

117. From the responses received to Q8 and Q28 on this topic, it can be said that a majority of respondents opposed (or strongly opposed) regulatory intervention to mandate platform trading. Many respondents cited the crucial and complementary role of OTC execution models, which underpin the ability to effectively hedge risk, particularly during times of market volatility. Many respondents also questioned the incremental benefits of platform trading in the context of existing EU initiatives (e.g. transparency in non-equity markets) and the core objective of reduction of systemic risk. Several references were made to the commercial viability of mandatory action in the context of less liquid products which may lead to the withdrawal of execution facilities and also some respondents considered that organised platform trading may limit the ability of the industry to develop new products. In addition, several respondents pointed to the pro-competitive model under MiFID which facilitates innovation, as an appropriate framework. Nevertheless, some respondents did favour mandatory action, citing the need to overcome inertia in the existing market structure.

CESR view

118. CESR believes that trading of standardised derivative products on Organised Trading Venues is to be incentivised by regulators, even though not mandated at this stage. Taking into account the comments received in the consultation and regulatory needs, CESR considers that a precise set of criteria has to be determined to define Organised Trading Venues. The proposed way forward is through the determination by ESMA of targets to be met by the industry. Should these targets not be met, appropriate mandatory regulatory action would then have to be taken to lead to the achievement of the targets by market participants. Therefore, CESR recommends the following policy approach taking into account the comments received in the consultation and the regulatory needs identified.

Nature of proposed regulatory action

119. In order to further the objectives of the G20, in relation to the promotion of an efficient and sound derivatives market, CESR proposes that steps should be taken to incentivise the increased use of organised platforms for the purpose of trading eligible derivatives products.
120. It is proposed that this action takes the form of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described in the sections that follow. Regulators need to be involved in the process to provide the framework for discussion, ensure appropriate commitments and monitor their achievement. In case the targets were not met, appropriate mandatory regulatory action should be initiated to ensure their achievement by the industry.
121. On the basis of an appropriate system of targets including appropriate monitoring and regulatory follow-up action, it will not be necessary to mandate trading of eligible derivatives on organised venues at this stage.

The minimum characteristics necessary for a platform to be treated as an organised trading venue

122. CESR considers that further work is necessary in order to determine the range of characteristics that a derivatives venue should possess so as to qualify as an organised trading venue and meet the objectives set forth by the G20. CESR recommends that such work be initiated as soon as possible and stands ready to assist the Commission in this regard. At this stage, CESR sets out the framework within which this further work should be conducted and the initial conclusions which can be reached.
123. CESR considers that the term “Organised Trading Venue” should be defined by reference to a range of functional characteristics that, collectively, will ensure that trading platforms meet the objectives set forth by the G20. Accordingly, a variety of trading methodologies might

qualify as organised trading venues, subject to satisfaction of the specific functional characteristics identified.

124. In CESR's view, it is clear that high standards with regards to market transparency and operational efficiency are, as a minimum, necessary to meet the G20 objectives. Hence, it should not be possible for a trading venue which did not meet these characteristics to qualify as an organised trading venue in this context. The existing market pre- and post-trade transparency standards set out in MiFID for equities should be used as a basis for further discussion of the appropriate trade transparency regime for derivatives, and to set out the benchmark against which these platforms should be measured. Such work should build on existing CESR recommendations in relation to transparency for derivatives products⁹ and take into account the particular needs of participants in derivatives markets. In addition, CESR considers that the incorporation of further functional characteristics into the definition of an organised trading venue will have to be assessed, based on a fuller assessment of their role in furthering the G20 objectives. Such characteristics may include some or all of the following:
- easy and non-discriminatory market access
 - non-discretionary and transparent rules
 - objective criteria for the efficient execution of orders
 - multi-laterality
 - authorisation/regulation and monitoring by competent authorities
 - operational resilience; and
 - surveillance of compliance with the organised trading venue's rules.
125. As an initial conclusion, it is clear that Regulated Markets and MTFs, as defined by MiFID, are organised trading venues in this context. These trading platforms meet the full range of functional characteristics described above and, accordingly, unequivocally meet the objectives of the G20.
126. In legislative terms, building on the conclusion of paragraph 49, the key objective of CESR's further work should be to determine whether other trading platforms, in addition to RMs and MTFs, meeting all or part of the requirements set out above, may qualify as organised trading venues. If a concept beyond the RM and MTF definitions was necessary, it is clear in CESR's view that the equities-focused regimes for systematic internalisers and broker crossing systems would not be appropriate as currently formulated.
127. In the context of the global nature of the derivatives market, and market reforms currently being pursued in the US, CESR considers that an additional objective of its further work should be to ensure international level playing field and mitigate the risk of regulatory arbitrage between markets in EEA countries and other financial centres. In particular, the further assessment of which ones of the characteristics set out above should be applicable to the EU concept of an organised trading venue, over and above the core characteristics of market transparency and operational efficiency, should accordingly be informed by the requirements for "Swap Execution Facilities" in the US. CESR notes that further clarification of how the US regime will be implemented should be forthcoming within the next few months, with rules due to be in place by July 2011. In principle, CESR considers that the definition of "organised trading platforms" to be developed in the European context should take into account the criteria defined above for the SEF aiming at the alignment of the regulatory outcomes.

⁹ CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity Markets Transparency, Ref. CESR 10-802



Eligibility of products for organised trading venues

128. It is proposed that, in order for a derivative product to be deemed eligible for trading on an organised trading venue, a number of pre-conditions must be satisfied. These are:
- (a) The derivative contract is standardised from the product, legal and process point of view; and
 - (b) The market for the derivative contract is sufficiently liquid.
129. A derivative product which meets these pre-conditions is referred to in CESR's advice as an "Eligible Derivative".
130. A derivative product already traded on a RM or an MTF should be presumed to be an Eligible Derivative (a minimum period of trading on a RM could be considered), unless in ESMA's judgement specific circumstances, such as a lack of liquidity in a RM/MTF-traded product, make this inappropriate.
131. Regarding bespoke contracts for non-financial-institutions with specific hedging needs, these are not covered by the "standardised derivatives" scope of CESR's present work.

The calibration and monitoring of industry targets

132. In order to effectively design, implement and oversee a system of targets, CESR proposes that ESMA be appointed to fulfil these functions. ESMA's responsibilities would include:
- (a) The determination of the Eligible Derivatives covered by the targets. In the case of a derivative product not already admitted to trading on a RM or an MTF, this would clearly be dependent on the willingness of a platform operator to make arrangements to trade the derivative. Where an organised trading venue would start offering trading in an OTC derivative, ESMA would follow developments and, in case of unsuccessful launch, seek to understand the reasons for it and take any further step that may be considered as appropriate. In the case where no organised trading venue comes forward with a proposal to trade standardised OTC derivatives identified in this process, ESMA will further discuss with the industry and particularly operators and/or potential operators of organised trading venues to, where appropriate, review the list of Eligible Derivatives identified.
 - (b) The determination of the targets: It is proposed that ESMA would determine the targets and the proportion of business in Eligible Derivatives that should take place on organised trading venues over a specified period of time (expressed as a percentage of total business by relevant participants in Eligible Derivatives over the same period of time).

In the calibration of those targets, the following general principles should be applied:

- i. Work should be undertaken to clarify with an appropriate degree of precision, the proportion of business in Eligible Derivatives already undertaken on RMs and MTFs. Targets should be set at an sufficiently ambitious premium to these existing levels, in order to effectively encourage increased platform trading;

- ii. The targets should take into account the possibility for market participants to undertake an appropriate level of business in Eligible Derivatives on an OTC basis, to meet their legitimate needs e.g. non-addressable liquidity and non price-forming transactions;
 - iii. The targets should be drawn up in consultation with the industry; and
 - iv. Where appropriate, the targets should be differentiated by asset class.
- (c) ESMA should be responsible for publishing the targets on the basis of determined objective criteria, and should also have discretion to publish a general statement, at an appropriate juncture, regarding the compliance or non-compliance of the industry with the targets.

Measurement and further action

- 133. The core principles of the objectives pursued and the approach taken by regulators to incentivise trading of standardised OTC derivatives on organised venues should be set in regulatory measures.
- 134. On that basis, ESMA would then determine the specific targets to be met. It is proposed that the measurement of compliance with industry targets could be performed using data from various sources, including data obtained from trade repositories, when such data becomes available.
- 135. In case the targets were not met, appropriate mandatory regulatory intervention should be adopted by ESMA (in conjunction with EEA national regulators) to lead to their achievement by the industry.