Answer to consultation CESR/10-292 on CESR Technical Advice to the European Commission in the Context of the MiFID Review - Transaction Reporting

1. **The Association française des marchés financiers (AMAFI)** has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

2. AMAFI welcomes the opportunity provided by CESR to answer its consultation on a matter on which its members have an extensive experience built across the years since MiFID was implemented and that is particularly important for market integrity, a fundamental principle that AMAFI fully embraces in its course of action.

In the present document, AMAFI wishes to make the general observations set out below (I) and provides some specific answers to the questions raised by CESR (II).

I. – *General Observations*

3. As a preamble, AMAFI regrets that the time allowed to respond to the consultation was not set at the three-month standard applicable to significant issues (see CESR's consultation policy – CESR/01-009). This is especially so since many consultations are on-going at national level as will as EU level, including the four consultations that CESR has launched at the same time with similar deadlines.

We regret that this short response time does not allow for a thorough examination of the questions raised and does not enable firms and associations to think of and propose thought out alternative solutions that meet the regulatory objectives at stake.

A pan-European approach to the collection of client ID and market surveillance in general, is necessary

4. As AMAFI has had the occasions to put it forward many times when MiFID was being discussed and in several of its answers to CESR's consultations thereafter, there is an inconsistency at the heart of the construction of the EU financial market which is aiming for an integrated and unique financial market but whose integrity relies on a fragmented surveillance split between 27 competent authorities. AMAFI is therefore a strong supporter of having a reporting model centralised at EU level. We recognise that this is not the choice that was made by the European Commission but the present CESR's consultation is an illustration of the kind of complexity and increased costs competent authorities and

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firms (and finally their clients, investors and issuers) would have to suffer to implement CESR's contemplated changes as a result of this choice of a reporting model based on multiple reporting to the various competent authorities.

It is common knowledge that, from the implementation of MiFID, authorities have adopted different approaches to transaction reporting, resulting for cross-border firms in duplication of reporting, different IT developments, complex internal organisations and regulatory risks. Such weaknesses should not be rendered more acute by adding to this original conception flaw. As a consequence, and although AMAFI is firmly in favour of market integrity and supports transaction reporting as a critical tool in this respect, it believes that, whenever possible, a pan European approach should be sought. Such a view applies particularly to the issues at stake here and permeates our answers to this consultation.

- ***Implementation of CESR's proposals would necessitate massive investments both from firms and regulators for a minimal benefit in terms of surveillance – a thorough examination of the issues at stake will call for a staged implementation***

5. AMAFI is of the view that considering the wide ranging and profound consequences of the proposals made by CESR, a thorough assessment of technical feasibility, costs and legal workability (as far as data privacy is concerned) is absolutely necessary. This should be looked at both from the perspective of firms and from the one of competent authorities. To reap the benefits of the changes and make them actual, competent authorities will have to make changes to their surveillance systems and organisations; they will also have to make use of TREM to a level where it should be integrated to the data they collect locally; and all this should be done according to a timeframe that allows the twenty-seven competent authorities to communicate and exchange efficiently together. These aspects are critical to assess the feasibility of the proposed changes and should be an integral part of the impact assessment that AMAFI considers as absolutely necessary considering the costs that would be incurred. These investments should be made for a result that can be delivered practically, which AMAFI does not believe possible as of today, the extent of the changes that should be implemented being disproportionate compared to the improvements they will bring to the surveillance systems.

One practical way to move forward could be to design a reasonable and practical solution as a first step that would maybe not be as ambitious as CESR's proposal to start with (see for e.g. § 47 below), with a view to adding to this first step to reach the desired objective. This approach would result in a staged implementation, spread over several years, which would allow firms and competent authorities to adapt progressively and to build a reporting system efficient both from a surveillance viewpoint and from an industry viewpoint.

- ***Examining data privacy issues is a pre-requisite to moving forward on client ID collection***

6. Such an approach would in particular give CESR some time to examine the issue of data privacy, which in our view is at the heart of the proposal to report client identifiers. In this respect, there should be close cooperation from the outset between competent authorities and the authorities in charge of enforcing data privacy laws to address valid concerns in terms of personal data.

The legality of the transmission with regard to EU legislation needs to be thoroughly assessed and, in some cases, national laws shall be adapted to allow firms to abide by this new requirement in a secured regulatory environment, based on a consistent and harmonised interpretation by the national authorities in charge of enforcing regulation on data privacy.

II. – *Questions*

- **Question 1: Do you agree with the above analysis on trading capacity and the proposal to introduce a third trading capacity (riskless principal) into transaction reports?**

7. The objective pursued by CESR is not clearly described in the consultation paper but AMAFI understands that there is a practical concern at stake that CESR wishes to address. As some types of transactions (the so called "riskless principal transactions") are not reported in the same manner across Member States, it disturbs the analysis a competent authority can make via TREM of the reporting a firm has made to another competent authority because the same transaction would be reported as agency in some countries and as principal in others. In particular, when such transactions are reported as principal, it creates a hindrance to an effective surveillance because competent authorities are not aware that a client is at the origin of the transaction. There is therefore an issue of homogeneity in the EEA with respect to the reporting of certain types of trades, which in turn hurts the quality of surveillance.

The introduction of a new trading capacity, for trades executed on the firm's own account on the order of a client, is supposed to solve this issue. This is however at the condition that each transaction corresponding to this definition can be reported as such. There are two pre-requisites for this to happen:

- The new trading capacity must be precisely defined and comprehended in the same way by all reporting firms to allow consistency in the EEA and, therefore, an efficient surveillance;
- Firms must have the capacity to identify these transactions distinctively from pure principal transactions.

These two conditions are however not met as explained below.

The new trading capacity must be precisely defined

8. On the first point mentioned above, one should note that this third trading capacity does not have a legal definition, at least in France, unlike the notions of dealing as principal or as agency. Also, depending on how it is called (and CESR uses various denominations in its paper like "riskless principal", "commissionaire" or "back-to-back" trades), it does not cover the same trading activities among member States. To our knowledge, the notion of riskless principal is not used in many Member States and in particular in France, and it would be interesting to check whether the introduction of this notion in all Member States is truly useful.

In addition, one important point, which is a prerequisite to any development on the subject, is to define consensually across CESR's members, what is a client order, which to date, has not been done. It is very likely that firms will not always have the same view as competent authorities on this subject, especially in OTC markets such as bonds and derivatives markets. Hence, AMAFI does not believe that CESR can introduce a third trading capacity for transaction reporting purpose only, without considering the wider implications of it (in terms of the application of principles such as the interest of the client, best execution, etc.).

This trading capacity hence needs to be precisely defined, using objective and distinctive criteria. This is essential to ensure, on the one hand, that the issue at stake is actually solved by the proposed change (i.e. if all trades executed on own account on the order of a client do not match the definition provided then the surveillance will not be improved greatly) and on the other hand, that there is consistency across firms' reporting to provide competent authorities with data they can rely on for their surveillance. The consultation paper does not provide at the moment this precise definition.

To illustrate further this point, if this third trading capacity is equated to back-to-back trades or riskless principal transactions only, as the CP seems to suggest, then there are clearly a number of transactions that will not enter this category, because they are not riskless, even though they are executed on behalf of a client on the firm's own account. This is so for example, when a firm commits on a firm price with a client for a number of shares and executes the transaction, wholly or partially, on its own account. The market side of the transaction would still be reported as a principal transaction because it is not riskless, even though it was executed on the order of a client on the firm's own account.

In short, if the scope is limited to riskless transactions then the surveillance will not be improved greatly because many trades done on the firm's own account on the order of a client would still be reported as principal transactions.

On the opposite, the introduction of this third trading capacity could also result in more trades being reported in this category rather than the agency one, which would be at odds with CESR's objectives. For example, one could consider that the use of internal accounts by brokers for the execution of orders at the VWAP (not guaranteed) could enter in this category because these trades are riskless. They would therefore not be reported anymore as agency but rather as riskless principal.

9. CESR's proposal is therefore not acceptable as is because it relies on concepts that are not defined homogeneously across member States and, as such, will not bring about the desired benefits in terms of surveillance. It is absolutely essential that CESR define more clearly its objective and determine which changes would actually meet this objective in a proportionate way. To this aim, CESR could identify the various positions a firm can be in when executing a client order on different venues and examine the outcome for each in terms of transactions reporting.

10. In the absence of this analysis, AMAFI considers that the proposal is not acceptable because it would not provide consistency across the EEA and would thus not be efficient from a surveillance point of view.

- ***Trading and booking systems are not able today to differentiate riskless principal transactions from pure principal transactions***

11. With the introduction of this third trading capacity, CESR assumes that systems are able to distinguish between trades executed on the firm's own account on the order of a client and pure principal transactions. However this is not the case, especially in countries where the riskless principal concept is not used as such.

12. This stems from the fact that legally speaking, there is no difference between the two situations (they both concern principal transactions), hence the booking of these trades are identical.

Also, there is no link operationally between the client side of a trade and the market side, even when the concept of riskless principal exists. As a result, firms are not able to report trades executed on their own account on the order of a client separately from the pure principal ones.

In addition, even if was possible (on the condition that firms embark in massive changes of their trading and booking systems), the relationship between a client order and a market transaction is not always one to one, i.e. part of the order can be filled directly on the regulated market in several tranches and part of the order can be filled on the principal account of the firm. A single reporting as proposed would therefore not work in this context, or it would require a complex system change by firms whereby the client side reporting would have to be broken down as many times as there are market sides and would result in multiple reporting.

The proposal to 1) identify riskless principal transactions distinctively and 2) file a single report for these transactions is therefore not workable.

- ***CESR should examine the implication of its proposal on trade reporting***

13. CESR should also consider the implications of this approach on the firms' trade reporting obligations. For a riskless principal transaction, the question of the publication of the OTC leg of the trade is raised, which could duplicate the publication already made for the market side (considering that the price is the same, i.e. no spread taken). This matter is linked to the definition of this third trading capacity as, if the definition includes the condition that the two legs' prices are the same, then no additional publication should be made to the market.

14. As a conclusion, AMAFI is of the opinion that CESR's proposal should not be pursued, as it would provide minimal improvements to the quality of the surveillance while requiring massive system changes from firms at a considerable cost.

- **Question 2: Do you have any comments on the distinction between client and counterparties?**

15. This distinction is certainly of importance if firms are to use the third party trading capacity for which a single transaction report would be made but the document does not explain how both matters are linked. Also, the examples provided do not seem to cover the situation of a riskless principal transaction.

We understand that for a riskless principal transaction, the client field would be populated with the ID of the entity giving the order and the counterparty field would be populated with the ID of the entity the order was filled with. But again, this distinction is useless as long as riskless principal transactions cannot be identified as such.

- **Question 3: Do you agree with the above technical analysis [on the benefits of collecting client identifiers]?**

16. AMAFI understands that the availability of client IDs would be an improvement for competent authorities from a market abuse point of view. However, for it to be the case, one can draw from CESR's analysis the conditions that should be met:

- Supervisory signals should be at the client level, not at the firm's level (§ 53 of CESR's document). It therefore calls for the use of European IDs (see § 29 below);

- The competent authorities should have the capacity to handle and make use of the data received (which will come in addition to the new feed they will receive on OTC derivatives) (the example of 7 million reports a day is provided § 55 of CESR's document), which requires organisational and system changes on their part that all of them may not have the capacity and resources to implement;

- Meaningful client IDs should be transmitted cross-border, since a good portion of transactions are being carried cross-border (§ 56 of CESR's document);

The proposal however does not meet these conditions, as we will show in our answers to questions 9 to 14.

17. We do not understand the comment in § 59 of CESR's document that the collection of client identifiers would help in policing short selling rules. Is it that competent authorities will reconstitute the clients' positions based on the transaction reporting to identify those that are short? If it is so, it seems a rather complex way of obtaining the information, especially since a much simpler solution would be to use data on failed trades that settlement systems monitor.

18. CESR comments in § 60 that developments made and costs incurred by some competent authorities and firms who have implemented the collection of client IDs will be lost if no harmonisation is reached.

However, the harmonisation across the EEA will not be at no cost for these institutions, since it is unlikely that the models implemented in each concerned country match the one proposed by CESR. International groups that have developed such reporting for their entities located in these countries are concerned over the fact that, in any case, they will have to redesign their reporting systems to fit with the new requirements, whereas they took considerable time and money to build and are complex to run. This initiative could, on the opposite, hurt the quality of their reporting, with regard to systems that are just about stabilised and bedded down, creating a significant regulatory risk.

19. Finally, the consultation paper highlights that a consequence of the collection of client IDs would be that ad hoc requests from competent authorities would drop in number (see § 61 of CESR's document). This is indeed an outcome that should be delivered. However, as regulators tend to include more information in their standard requests (such as the client's address, the name of the broker when appropriate, the names of the salesperson and the trader) than the ones that would be available in the reporting, it is unlikely that this benefit will be fully realized and in any case, that this reduction in cost would be proportionate to the additional costs firms would have to bear to comply with the proposed reporting system.

- **Question 4: Do you see any additional advantages in collecting client ID?**

20. No.

- **Question 5: Do you agree with the above technical analysis [on the disadvantages of collecting client ID]?**

21. Please see below question 6.

- **Question 6: Do you see any additional disadvantages in collecting client ID?**

22. A major disadvantage of collecting client ID is that the current MiFID option that competent authorities can use to allow firms to rely on the reporting performed by a regulated market or an MTF (*MiFID level I, article 25-5*) will be of no use anymore because, for commercial reasons, firms will be reluctant to transmit their client IDs to such markets.

In France, as the AMF has exercised this option, firms will therefore have to modify their current reporting set-up and develop a much wider spectrum of reporting than is currently the case.

This could be very detrimental for smaller firms who do not have the resources to build a reporting system and will not be able to rely on an authorised reporting mechanism.

23. Another disadvantage is for firms who currently rely on other firms to do their reporting, as these firms will not be able to maintain this organisation (except arguably for firms within a group) to the extent that the firms they rely on would now have access to their client IDs. These firms would therefore have to develop their own reporting, generating additional costs both initially and on-going and disturbing the communication channels established with the competent authority with regards to market surveillance.

24. Another disadvantage of collecting client IDs is that it could potentially disorganise the current reporting set-up within groups depending on the manner in which it is implemented. In those groups where branches receive and transmit orders for execution by the parent company, the reporting effort will be multiplied if reporting also has to be performed at branch level, which would be the case if the branch's local competent authority chooses the direct reporting option (see § 41 below).

25. Another issue that would need to be addressed is whether there is in each Member State a legal base to authorise the transmission of client information cross-border (be it via direct reporting or TREM). This question could be quite prominent in several Member States and not least in France where there is a banking secrecy principle entrenched in the legal framework under which firms operate.

It is absolutely necessary that CESR examine this issue with the help of experts of data privacy legislations (European and national legislations).

- **Question 7: Do you agree with this proposal [to amend MiFID to make the client ID collection mandatory]?**

26. In principle, this change would be useful from a market abuse point of view. However, AMAFI does not agree with CESR's proposal because:

- It would lead to disproportionate costs and complexity compared with the benefits it will bring, especially since the benefits in terms of fighting market abuse will be limited because there are many deficiencies inherent to the proposed system that will make it inefficient.
- The proposal is not feasible as such (see from § 38 below).

- **Question 8: Are there any additional arguments that should be considered by CESR?**

27. Please see previous answers.

- **Question 9: Do you agree that all counterparties should be identified with a BIC irrespective of whether they are an EEA investment firm or not?**

28. Yes but there may be difficulties in doing so in a consistent way for counterparties who have multiple BICs.

- **Question 10: Do you agree to adapt coding rules to the ones available in each country or do you think CESR should pursue a more ambitious (homogeneous) coding rule?**

29. AMAFI supports the view that a pan European code should be set up, i.e. that CESR pursue a more ambitious coding rule, as it is the only option that could enable surveillance at the client level (even though clients from outside the EEA would remain non identified).

30. It believes that the use of national codes is the worst option amongst the three because it is unworkable. Although on the principle, it has the advantage that any client who is an EEA national, will be identified with the same identifier, wherever it gives an order in the EEA, AMAFI does not believe that firms will be able to make this work homogeneously because of the complexity attached to it.

In practical terms, this solution entails that each firm would have to maintain a table populated with the list of preferred codes for each of the 27th countries! It would then have to collect the applicable code for each of its clients, record it and maintain it, which is a massive effort to go through, and be able to feed its reporting with it.

The fact that different codes are possible for each country is also introducing the risk that a firm identifies its client with one code and that another firm identifies the same client with another code, hence reducing to nil the chance that a meaningful surveillance at client level, across firms and across countries, could result from it. Compared to a pan-European code, it will also be a hindrance to the immediate use of information by competent authorities, as there would be no consistency in the EEA hence requiring constant communications between authorities to make sense of the client IDs collected.

In addition, one should note that this solution does not work for clients who are nationals (or registered) outside the EEA, unless CESR provides a list of codes for the countries of the rest of the world. This is a major drawback since trades initiated by such clients can represent a significant volume.

Finally, a client who wants to commits a market abuse will easily circumvent the rules and provide different codes to the firms it is trading with to avoid being detected by market surveillance tools. This option is too easy to get round, hence denying the purpose of the reporting.

- **Question 11: Is there any other available existing code that should be considered?**

31. Not that AMAFI is aware of.

- **Question 12: When a BIC code has not been assigned to an entity, what do you think is the appropriate level for identification (unique securities account, investment firm, national or Pan-European)?**

32. AMAFI is of the opinion that, if a pan-European code is not made available, the other options are not workable and/or efficient from a surveillance point of view, while they are likely to destroy the equilibrium that was finally found after MiFID's implementation in respect of reporting, to introduce increased complexity to the detriment of efficiency and to require considerable investments from the industry.

33. Having said that, if CESR was not to reconsider its proposal, the most practical level for identification would be the firm level. The national level is not appropriate for the reasons mentioned above (see § 29) and the unique securities account would be of poor value for surveillance purpose.

Also, a code at a firm level can be advantageous to avoid disclosing a client ID to competitors along the chain (providing no client name is added to it).

- **Question 13: What kind of problems may be faced at each of these levels?**

34. **For identification at the national level**, please see above § 30.

35. **For identification at a firm level**, firms will be faced with the necessity to have only one identifier across their trading activities for the same client, which is not necessarily the case today. Firms would therefore have to carry out an important harmonisation effort of their client reference data.

From a surveillance point of view, and providing all other problems are solved (see from § 38 below) this solution is less efficient than a pan-European code because surveillance systems will trigger alerts at a client/firm level rather than at the client/EEA level.

36. **Identification at a pan-European level**, as already identified by CESR, would necessitate that data privacy concerns be addressed properly, but this option provides the greatest advantage in terms of surveillance, and all of the options proposed should anyway be considered from a data protection point of view.

37. **Identification at the securities account** would be of poor value in terms of market surveillance as no alert at a client level could be generated by surveillance systems. Also this solution would be at odds with the consistency needed at European level and would allow people who want to commit market abuse to circumvent the system easily simply by opening new accounts.

- **Question 14: What are your opinions on the options presented in this section [on client ID collection when orders are transmitted for execution]?**

An issue common to both options: clients located outside of the EEA will not be identified

38. Clients and transmitting firms located outside the EEA are not subject to EEA regulation, hence in situations involving clients or transmitting firms located outside the EEA, IDs of end clients will not be available and their market activities will not be detectable based on client ID. This is a major drawback since the international nature of financial markets involve that a large proportion of transactions are executed for clients located outside of the EEA (like for example US pension funds).

This raises concerns over the efficiency of the proposed reporting system and seriously questions the cost/benefit ratio of the proposal.

This matter is also important to consider to the extent that a client who wants to commit market abuse will have the ability to use this weakness to trade without being identified, i.e. it could trade via firms outside of the EEA. More generally speaking, the reporting model should consider the intention of people who commit market abuse and should be designed to thwart their attempts.

Option 1: Direct reporting by transmitting firms to competent authorities

39. This option sets that firms transmitting client orders to another firm for further transmission or execution report this transaction to their competent authority with the corresponding client ID.

In AMAFI's view, there are several hindrances to the workability of this option.

- In cross border situations, the information would be disseminated across several competent authorities

40. In cross border situations, the use of this option means that a transmitting firm in a Member state will report directly to its competent authority and will therefore not communicate the client ID to the executing firm, who could be located in another Member State. This option leads to the situation where the competent authority in charge of the surveillance of the transactions executed on its territory, will not have the client ID in its surveillance system. It will have to get this information from TREM and have the capacity to match both information and, if it is to generate alerts at client level, its surveillance system will need to consider information contained in TREM as well as information contained locally.

Considering also the number of transactions TREM will house, it casts doubts on the actual use a competent authority can make of this information for surveillance at client level. This should be of concern to CESR, as it is easy to trade with different firms in different Member states.

Option 2, transmission of the client ID to the receiving firm, would not create this kind of issue for cross border trades.

- This option results in significant costs and added complexity for transmitting firms and groups with branches in several Member States – it annihilates the benefit of the current model that required much work and discussions, of avoiding duplications of reporting

41. The new requirement would entail that transmitters would have to develop a reporting mechanism from scratch which is not a minor effort in terms of time, cost and complexity. Imposing such a requirement on transmitting firms that have sometimes very limited resources should be carefully considered. Such a requirement would create another barrier to entry and is likely to contribute to the concentration trend of the industry.

It would also create a multiplication of the reporting volume and result in redundancies. Will competent authorities' surveillance systems be able to find their way around them? Is this efficient from an economic point of view?

42. In addition, this requirement would create a regulatory risk, new to the transmitter but well known and already managed by the executing firm for its own account.

It is therefore likely that some transmitters will want to outsource their reporting to an executing firm (especially if no client name is part of the code and the code is at a firm's level). From a commercial viewpoint, it is unlikely that executing firms could reject these requests. They will end up providing this service at little or no cost, whereas meanwhile it is likely to be considered as the outsourcing of an essential or important operational task and therefore be conditioned to full compliance with the corresponding rules set in MiFID, which are very engaging and difficult to comply with. The requirement on transmitters to create a reporting system is therefore likely to create commercial strains with executing firms.

43. As far as groups are concerned, when, in a group, branches transmit orders for execution to their parent company, MiFID rules that the parent company carries out the transaction reporting to its competent authority and the branches do not report to their local authority. Hence, in such situations, no reporting mechanism exists at the branch level.

With this option, a group would have to develop transaction reporting from its branches to their local authorities, denying all the efforts made so far to avoid multiplication of reporting and undue costs, with two consequences:

- a complete remodelling of the reporting model set up just three years ago, with the financial and organisational implications it has (different reporting systems with different requirements hence technical complexity and a need for expertise; more complex monitoring of the quality of the reporting carried out by the group and increased regulatory risks)
- a multiplication of the reporting effort by the group.

This seriously questions the cost/benefit ratio of the proposed option.

44. One could argue that branches could use option 2 to transmit their client IDs to the parent company but in this case, the choice between the two options should not be left to competent authorities, which is the current proposal.

45. As a conclusion, AMAFI is strongly against direct reporting by transmitting firms. In its view, it does not bring the expected efficiency from a surveillance viewpoint and it would result in significant costs across the financial industry.

- ***Option 2: Transmission of client ID along the chain to the execution firm***

46. As pointed out by CESR, this option alone is not workable because it is likely that disclosing their clients' identities to another firm will cause concern to many transmitters for commercial reasons.

Even when it is the option chosen by a firm, there will be occasions where a transmitter will not communicate its client ID to the receiving firm[1]. If CESR was to maintain its proposal, responsibilities should therefore be made clear at the Directive level that the receiving firm is expected to report the information it is provided (i.e. its reporting will lack the client ID in these situations) and that it cannot be held liable for any incompleteness that results from someone else's failure, nor be expected to chase transmitting firms (especially since the coexistence of the two options could explain that a client ID is not communicated).

47. Because this option is not feasible alone, and the other one raises significant concern from a cost/benefit angle, AMAFI is of the opinion that none of the proposed option should be pursued. An alternative could be for firms to communicate the name of their order giver, even though this information is not available at the execution level, but rather once the trades are allocated.

- **Question 15: Do you agree with CESR's proposal on the extension of reporting obligations [to market members not authorized as investment firms]? If so, which of the two alternatives would you prefer?**

48. AMAFI has not made a choice on the two alternatives proposed but considers that in principle a market member, be it authorised as an investment firm or not, should indeed be subject to the same surveillance framework since it should operate with the same level of ethics on this market and it also plays a role in maintaining the market's integrity.

[1] This will happen for example for cross border trades where the transmitting firm has a requirement to report directly to its local authority, in which case it will not transmit this information to the execution firm.