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British Bankers Association (BBA)
International Capital Market Association (ICMA)
London Investment Banking Association (LIBA)
International Swaps and Derivatives Association (ISDA)
Asociación de Mercados Financieros (AMF)
Association of Foreign Banks (AFB)
Association of Private Client Investment Managers and Stockbrokers (APCIMS)
Associazione Italiana Intermediari Mobiliari (ASSOSIM)
Bundesverband der Wertpapierfirmen an den Deutschen Börsen e.V. (BWF)
Danish Securities Dealers Association (DSDA)
Euribor ACI European Commission Working Group
Finnish Association of Securities Dealers (FASD)
Futures and Options Association (FOA)
Icelandic Financial Services Association (IFSA)
Norwegian Securities Dealers Association (NSDA)
Securities Industry and Financial Markets Association (SIFMA)
Swedish Securities Dealers Association (SSDA)

JOINT RESPONSE TO CESR CONSULTATION PAPER CESR/07-047 – CESR LEVEL 3 GUIDELINES ON MiFID TRANSACTION REPORTING

The Associations named above welcome the opportunity to respond to CESR's Consultation Paper (CP) on the proposed Level 3 Guidelines on MiFID transaction reporting. We have set out in the Annex our response to the questions raised in the CP. In this covering note, we focus on three general issues affecting our response: first, the need for clarification on transaction reporting issues as soon as possible; second, the transitional issues for firms; and third, our analysis of CESR's proposed booking test and the "characteristic performance" test.

Need for clarification on transaction reporting issues

Transaction reporting is a vital issue for CESR to resolve quickly. In firms' implementation of MiFID, those areas of the requirements that entail major IT change and associated large internal projects must be resolved by CESR sufficiently far in advance of required compliance so as to give firms the ability to comply. Transaction reporting is one of these areas. We would urge CESR to finalise concrete proposals for Member States' transaction reporting requirements as soon as is practicable in order to give firms sufficient time to implement this element of their MiFID programme.

In particular, in addition to the issues covered by CESR in the CP, firms need to know whether CESR will be producing any further guidance on transaction reporting on other issues not covered in the CP, and if so what will be covered and when. At the CESR hearing in Paris on 1 March, respondents were encouraged to identify additional concerns. We emphasise three in particular:

First, CESR's CP does not discuss the use of unique client identifiers. Under MiFID it is not mandatory to add a unique client field to the transaction reporting fields. The FSA has required a unique client identifier for some time for transaction reports in respect of financial instruments reported at present, and intends to continue and extend this under

MiFID. There is some uncertainty on whether or not there are any regulators who currently do not require client identifiers who will change their position and require them.

The view of our members is that there is still a considerable amount of work to be done (in a small space of time) in respect of modifying transaction reporting systems in order to comply with the MiFID transaction reporting requirements. On this basis, it would be unhelpful for national regulators in Member States to impose new national reporting requirements at present. In view of this we oppose new changes by national regulators at present to impose client identifier requirements.

Should a particular national regulator nonetheless decide to impose this new requirement, however, it is vital that the regulator concerned should publish its intention as soon as possible. This is because these types of additional requirements will often have to be built into firms' transaction reporting systems (which are currently being built to meet the requirements of more than one national regulator), and it is wasteful and expensive to have to build them in piecemeal fashion as one regulator after another change their view on this issue.

Second, we had previously understood that the list of reportable instruments required by Article 11 of the Level 2 Regulation was to be made generally available to firms and/or reporting systems. This seems to us to be the purpose of the Article, and any other interpretation may place exchanges at an unfair advantage in promoting their reporting systems.[1] However, we now understand that it is possible that, under a contract between CESR and a supplier, this may no longer be the case. We emphasise that firms need free access to a public list of reportable instruments required under MiFID, and that they each need to be clear about this as soon as possible.

Third, the arrangements for the reporting of commodity derivatives have clearly not been regarded as a priority and are only now, belatedly, receiving regulatory attention. We are also concerned about the approach that is being taken, and whether it is justified on the basis of a cost-benefit analysis. The insistence on ISO standard codes, notably ISIN numbers, is not appropriate for these markets, given that contracts are particular to individual exchanges and do not represent – and are not linked to – securities that can be traded across several venues. CESR has paid insufficient attention to the costs to firms involved in forcing the reporting of commodity derivatives into a framework designed for securities reporting and has failed to identify any benefits that might accrue. Position reports are much more relevant for ensuring the integrity of commodity derivatives markets. We therefore consider that a proper cost-benefit analysis should be undertaken, and publicly disclosed.

More time (beyond 1 November 2007) is needed to develop and implement a practical approach to the reporting of commodity derivatives. CESR should consult separately on: the scope of transactions to be reported; the costs and benefits of using exchange codes as an alternative to ISIN numbers; and whether exchanges can deliver, at a proportionate cost, reporting on behalf of their members.

[1] For example, the FSA said in its Policy Statement (07/2) on 26 January 2007 (#14.14 on page 68): "It is expected that the list [of reportable instruments required by MiFID] will be made easily available; this issue will be covered in the CESR Reference Data Logistics Programme and full details are expected to be available from July 2007."

Finally, it would be helpful if CESR would encourage all competent authorities to state whether they will be ready to receive transaction reports from firms from 1 November 2007 and, if not, when they will be ready. At the CESR hearing in Paris on 1 March, CESR said that no competent authority had so far stated that it would not be ready, but we understand that only a few competent authorities have provided technical specifications so far. Competent authorities' specifications and firms' preparations are interdependent. In addition, it would be helpful if CESR would encourage national regulators to produce any guidance on transaction reporting for firms as soon as possible.

Transitional issues for firms

While we recognise that CESR is doing its best to deal with a complex subject against tight deadlines, it nonetheless remains the case that firms are unable to start developing the specifications needed to modify their transaction reporting systems on the basis of the MiFID text and the current CESR CP. Substantial additional clarity is required before this can be done.

Long lead times are required to make systems changes. The specifications required need to be clear, code changes need to be written and systems need to be properly tested before they go live. Moreover, if a firm will be reporting through another party – e.g. an exchange or an ARM[2] – the firm needs to know the systems requirements of that institution before it can put in place its own systems changes. The precise amount of time needed for the changes will vary from firm to firm depending upon the complexity of their systems, but it is not unreasonable to expect that for more complex systems changes around a year will be needed to move from the point of specification to the point of implementation.

In view of this, it is clear that, owing to the delays by Member States in transposing MiFID and the fact that insufficient clarity has been provided (as yet) regarding the relevant transaction reporting requirements, there are grave concerns that firms will not be in a position to implement transaction reporting changes by 1 November 2007. Indeed, until greater clarity is given there is little prospect of being able to form a view on how long it will take to carry out any transaction reporting changes that will need to be made.

We would be keen to discuss with CESR and the European Commission the best transitional solution for firms and a realistic timeframe for implementation. This should take into account the extent to which the time that the Commission originally promised would be available for firms is in practice being eaten up by late transposition by Member States.

[2] There are some current arrangements for transaction reporting and market monitoring that provide the regulatory outcomes required by MiFID (i.e. reporting obligations on firms are discharged and regulators receive the information required). However, because of the technical terms used in MiFID, these current arrangements will have to be replaced, at significant cost to firms across the industry, for little or no regulatory benefit. CESR can assist in avoiding the imposition of this unnecessary cost if it works to achieve pragmatic results in these areas (e.g. by allowing firms trading on exchanges to report to the competent authority of that exchange).

CESR’s proposed booking test and the “characteristic performance” test

We consider that CESR’s proposed booking test is a sensible, simple and pragmatic test which might form a basis on which to proceed with transaction reporting, particularly with regard to branches, in the absence of clarity being provided about the legal analysis of Article 32.7 of MiFID. We outline below the legal analysis of Article 32.7 which we believe to be the most practical one, and the one which fits best with existing EU law and the existing EU financial services legislative framework (particularly the Banking Directives).

Article 25.3 of MiFID Level 1 states that: “Member States shall require investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day. This obligation shall apply whether or not such transactions were carried out on a regulated market.”

However, Article 25 interacts with Article 32 of Level 1, which sets out provisions for Member States’ competent authorities to regulate branches on a “host state” basis: “The competent authority of the Member State in which the branch is located shall have the right to examine branch arrangements and to request such changes as are strictly needed to enable the competent authority to enforce the obligations under Articles 19, 21, 22, 25, 27 and 28 and measures adopted pursuant thereto with respect to the services and/or activities provided by the branch within its territory.”

CESR’s CP states that “a solution where reports by branches would only be channelled to the ‘home’ authority of the firm is not possible.” As this does not represent a practical and workable solution to transaction reporting, a firm’s reporting must be split, dependent on how business is carried out in Member States.

Our members consider that the “characteristic performance” test is more appropriate than the “solicitation” test in determining the outcome for cross-border transaction reporting. We do not believe that it would be practicable for firms to implement the solicitation test, which is based on the location of the customer. We would also highlight the interaction between the Banking Directive and MiFID. Using the characteristic performance test would mirror the approach in the Banking Directives. Given the significant interaction between MIFID and the Banking Directives, it would make sense to adopt the same interpretative approach as has been taken with those Directives.

We set out below a brief description of the two main branching models used by banks and securities firms in Europe followed by an analysis of how the ‘characteristic performance’ test could operate when applied to transaction reporting.

Simple Head Office/Overseas Branch Model

In this case the bank will be based in one Member State and often have one branch in, say, 5 or 6 other Member States. The branches will typically use the back office and settlement systems of the head office and their role will be to develop client relationships in the host state and also, frequently, adjoining states where there is no branch (e.g. a branch in Brussels may have clients in the Netherlands, Belgium and

Luxembourg). Branch staff will, typically, offer investment advice and will receive and transmit orders but will not execute orders. Instead, orders transmitted by the branch will usually be executed in a dealing room back at head office.

Analysis of this model using the "characteristic performance" test

In this model our analysis of the "characteristic performance" test would be that host state rules and supervision would apply to the giving of the investment advice and the receipt and transmission of orders and the host state supervisor should supervise these services. The execution of the orders, and the transaction reporting of them, should in contrast be subject to home state rules and home state supervision.

Head Office with Branch as Execution Hub

This is the second leading model used in Europe. It reflects the fact that firms often wish to concentrate dealing in one location. Often, as in the first example, the dealing will be located at head office. However, in some cases the head office is not located in a centre with a strong trading tradition. In those cases some firms have chosen to use a branch based in a jurisdiction from which trading is frequently conducted, e.g. London or Luxembourg, rather than head office, as the location of their trading floor. In such cases the model is usually to have a head office and a range of branches which are simply providing advice and receipt/transmittal of orders, but also to have one or more branches which are executing the orders received either directly from the branch customers, from other branches or from head office.

Analysis of this model using the "characteristic performance" test

In this model the "characteristic performance" test would result in a different analysis with regard to the branch acting as execution hub. The branch would be carrying out the MiFID service of execution of orders on behalf of clients (Annex 1 Section A (2) of MiFID). As a result the host state, rather than the home state, would be responsible for the supervision of the orders executed by the branch. It would be host state rules on transaction reporting which would apply.

Applying the characteristic performance test to MiFID services provided through branches would:

- Be consistent with the Banking Directives, which is important as MiFID applies to many credit institutions as well as investment firms.

- Give greater clarity than alternative tests, as it is relatively straightforward to work out what is the "characteristic performance" of each of the eight MiFID services.

- Fit better with the branch models currently employed by firms.

- Mean that there would be less duplication of home and host rules, as application of the test would typically indicate whether home or host should apply.

- Significantly reduce the risk of multiple sets of rules having to be applied by one branch (as would be the case if the focus was on the location of the client – rather than the characteristic performance of the service).

- Give greater clarity to supervisors – although home and host supervisors would still have to cooperate and exchange information to enable them to carry out their supervisory obligations.

- Enable firms to give greater clarity to clients/customers about which rules would apply to them.

We support a speedy, concrete and practical solution to the question of transaction reporting. That is, for the most part, transaction reports should be sent to the competent authority of the Member State that the business takes place in – defined by the characteristic performance test. Whilst our members are supportive of Member States' regulators taking a flexible approach, CESR needs to outline one consistent approach. Many of our member firms carry out cross border business in a variety of models across many Member States. A system whereby agreements are outlined bilaterally and then renegotiated on an *ad hoc* basis cannot work for a major global market place.

ANNEX I: ANSWERS TO QUESTIONS IN CESR'S CONSULTATION PAPER

Reporting by branches

Question 1: Do respondents agree with the proposed guidelines?

We agree that CESR guidelines are needed. These guidelines should take the form of a multilateral agreement between CESR members on the basis of which firms can design their systems to implement the transaction reporting requirements in MiFID, rather than *ad hoc* bilateral arrangements between national regulators and firms.

Clearly, branches of firms should only be required to report once to one competent authority. Given CESR's work on the Transaction Reporting Exchange Mechanism (TREM), there should be no need for firms to go through the excessive and duplicative process of reporting to more than one relevant regulator. Members States' competent authorities should facilitate the prompt exchange of transaction reports to relevant supervisors.

In this context, we consider that branches should report transactions to the host state regulator on the basis of the "characteristic performance" test, though we consider that CESR's proposed booking test is a sensible, simple and pragmatic test which might form a basis on which to proceed with transaction reporting, particularly with regard to branches, in the absence of clarity being provided about the legal analysis of Article 32.7 of MiFID (see below).

However, CESR's approach to branch reporting of transactions – that branches of firms may report to the host state regulator *if the investment firm elects to do so and in agreement with the home state regulator* – would be much too complicated to implement in practice. It could also lead to uncertainty and delays, and would result in less harmonisation across the EEA .

Question 2: Do respondents consider that guidance is needed on which transaction is executed by a branch or by its head office for the purpose of reporting it to the relevant competent authority? If yes, do respondents consider that transactions executed by a branch should be understood as those transactions booked by the branch?

Yes, guidance is needed.

We consider that CESR's proposed booking test is a sensible, simple and pragmatic test which might form a basis on which to proceed with transaction reporting, particularly with regard to branches, in the absence of clarity being provided about the legal analysis of Article 32.7 of MiFID. We outline below the legal analysis of Article 32.7 which we believe to be the most practical one, and the one which fits best with existing EU law and the existing EU financial services legislative framework (particularly the Banking Directives).

As outlined in our cover note, we consider that the appropriate method of determining where transactions should initially be reported is the characteristic performance test rather than the solicitation test. This means that, for the most part, transaction reports should be sent to the competent authority of the Member State where the business takes place – defined by the characteristic performance test.

- In the case of the "Simple Head Office/Overseas Branch Model", where orders transmitted by the branch in one Member State are usually executed in a dealing room at head office in another Member State, the execution of the orders, and the transaction reporting of them, should be subject to home state rules and home state supervision.

- In the case of the "Head Office with Branch as Execution Hub Model", where orders transmitted by the head office in one Member State are usually executed in a dealing room in a branch in another Member State (e.g. in a centre with a strong trading tradition), the host state – rather than the home state – would be responsible for the supervision of the orders executed by the branch, and the host state rules on transaction reporting would apply.

Applying the characteristic performance test to MiFID services provided through branches would:

- Be consistent with the Banking Directives, which is important as MiFID applies to many credit institutions as well as investment firms.

- Give greater clarity than alternative tests, as it is relatively straightforward to work out what is the "characteristic performance" of each of the eight MiFID services.

- Fit better with the branch models currently employed by firms.

- Mean that there would be less duplication of home and host rules, as application of the test would typically indicate whether home or host should apply.

- Significantly reduce the risk of multiple sets of rules having to be applied by one branch (as would be the case if the focus was on the location of the client – rather than the characteristic performance of the service).

- Give greater clarity to supervisors – although home and host supervisors would still have to cooperate and exchange information to enable them to carry out their supervisory obligations.

- Enable firms to give greater clarity to clients/customers about which rules would apply to them.

By contrast, we do not believe that it would be practicable for firms to implement the solicitation test (i.e. based on the location of the customer).

What constitutes execution of a transaction (to be reported)

Question 3: Do respondents agree with the proposed guidelines?

CESR says (#3) that "some issues have been identified where there is a need for [a] harmonised approach by CESR members". However, that is not the case with CESR's proposals on what constitutes execution of a transaction to be reported. CESR says (#22) that its members "commit themselves to including in transaction reports those transactions which are conducted by the immediate market facing investment firms and those transactions where the investment firm is undertaking the transaction on its own accounts (either on market or off-market)." But CESR also says (#23) that "individual Member States may widen the scope of the national transaction reporting regime to include also 'client-facing' investment firms in addition to the 'market-facing' firms".

We agree with CESR that it is right to focus on collecting, and where required, exchanging information about transactions conducted by the immediate market-facing investment firm. We also agree with CESR's proposal to develop a common approach towards transaction chains. We are concerned, however, by the suggestion (#23) that "Member States may widen the scope of the national transaction reporting regime to include also 'client-facing' investment firms".

While we recognise that some Member State regulators already do this, we do not consider that it is sensible at present for national regulators to be introducing new, and potentially very significant, changes to their reporting regimes. As we said with regard to client identifiers in our cover note, it would be very unhelpful for Member State regulators to impose new national reporting requirements at present. There will already be a considerable amount of work (and too little time) for firms to modify their reporting systems by 1 November 2007. In view of this we oppose new changes by national regulators to impose client side reporting requirements at present.

It is also not clear to us why widening the scope of the national transaction reporting regime to include client-facing investment firms would help regulators to detect market abuse in some countries, but not in others. And we note the Commission's reservations, expressed at the CESR hearing in Paris on 1 March, about CESR's approach to the interpretation of MiFID in this respect.

Should a particular regulator nonetheless decide to impose new requirements, it is vital that they confirm their intention as soon as possible. This is because these types of additional requirements will often have to be built into a firm's transaction reporting systems which are currently being built to meet the requirements of more than one national regulator. Furthermore, it is time-consuming and expensive to have to build such changes to transaction reporting systems in a piecemeal fashion as one regulator after another change their view on this issue.

Approval of reporting channels

Question 4: Do respondents agree with the proposed guidelines?

We welcome CESR's practical guidelines on approved reporting mechanisms. As CESR states, the streamlining of the process whereby national regulators take into account the existing work done by other Member States' competent authorities is an outcome the industry would support. CESR should encourage its members to move towards convergent processes over time through examining the relative merits of different approaches across supervisors.