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CONSULTATION PAPER

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

Deadline for contributions: CESR invites responses to this consultation paper by **31 May 2010**. All contributions should be submitted online via CESR's website under the heading 'Consultations' at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests its submission to be confidential.

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Executive summary

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

The proposed main amendments focus on the following areas:

- Introduction of a third trading capacity (riskless principal);
- Collection of client and meaningful counterparty identifiers – CESR would like to suggest to the European Commission that the collection of client IDs and meaningful identifiers for all counterparties would be made mandatory to all competent authorities
- Standards for client and counterparty identifiers – CESR elaborates on possible guidance and future standards for client and counterparty identifiers;
- Client ID collection when orders are transmitted for execution - CESR suggests amending MiFID to enable competent authorities to require that, when orders are transmitted for execution, the transmitting firm either provides the client ID to the receiving firm or reports the trade, including full client ID, to the CA; and
- Transaction reporting by market members not authorised as investment firms - CESR suggests amending MiFID by introducing a transaction reporting obligation to those persons that are members of a regulated market or MTF or, alternatively, by introducing a similar obligation on regulated markets or MTFs that admit these undertakings as members.

Stakeholders are being consulted on their views on CESR's proposal for MiFID amendments in relation to transaction reporting and whether there are other areas where they would like CESR to conduct further work in relation to transaction reporting. The deadline for responses to this consultation is 31 May 2010.

1 Introduction

1. Within the overall MiFID framework and with regard to CESR members' obligation to monitor the activities of investment firms to ensure that they act honestly, fairly and professionally and in a manner which promotes the integrity of the market, Article 25(3) of MiFID obliges investment firms to report executed transactions to their competent authorities.

2. Transaction reporting data is needed to enable supervisors to detect and pursue suspected instances of market abuse, client abuse or other breaches of relevant MiFID provisions.

3. MiFID transaction reporting regime is based on reporting of executed transactions and not on information on individual orders. In that regard, Article 5 of the MiFID Implementing Regulation clarifies that for these purposes 'transaction' is a reference only to the purchase and sale of a financial instrument, excluding securities financing transactions, the exercise of options or of covered warrants, primary market transactions (such as issuance, allotment or subscription) in financial instruments falling within Article 4(1)(18)(a) and (b) of MiFID.

4. Article 13 of the MiFID Implementing Regulation and its Annex I set out the content of the transaction reports that investment firms that execute transactions in financial instruments admitted to trading on a regulated market have to report to their competent authorities.

5. Since the drafting of the MiFID Implementing Regulation CESR members have been aware of the difficulties in achieving an entirely homogeneous transaction reporting system across Europe. As the transaction reporting systems and market structures were considerably different, CESR proposed in its advice to the European Commission not to impose a single system to investment firms, but to build on the existing systems in order to avoid unnecessary costs for investment firms. The exchange of transaction reports would therefore be organised only between securities regulators, each regulator having the responsibility to collect necessary transaction reporting data from the firms it supervises, according to its specific arrangements.

6. To address the technical impact on market participants that the lack of a more convergent approach could cause, CESR published the CESR Level 3 Guidelines on MiFID Transaction Reporting (Ref. CESR/07-301) in May 2007. The guidelines covered non-technical issues where there was a need for a harmonised approach by CESR Members: transaction reporting by branches; scope of the transaction reporting obligation (i.e. what constitutes 'execution of a transaction' for transaction reporting purposes); and approval of reporting channels.

7. In that document, after considering necessary to separate execution of a transaction from reception and transmission of orders, it was also acknowledged that there are many different circumstances in which transactions take place, being impossible at that stage to reach a total agreement on the concept of 'execution of a transaction' consistently applicable across Member States. Moreover, it was recognised that competent authorities have a justifiable need to specify under which circumstances transactions are executed and hence need to be reported.

8. However, in order to establish a minimum level playing field and facilitate the implementation of MiFID, CESR members agreed to exchange the information in points (a) and (b) below and, if requested and when available, the information in point (c):

   a) *information relating to transactions conducted by the investment firms transacting directly with an execution venue (immediate market facing firm);*

   b) *information relating to transactions not covered by (a) above but where the investment firm is undertaking the transaction on its own accounts (regardless whether the transaction is executed on an RM or MTF or outside them); and*

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

9. Item c) above was included since CESR members agreed that in addition to transaction reports, competent authorities need other information on the different steps of executing a transaction. Due to the different practices from member to member, further information (including the identity of the originator of the order) may be collected as part of the transaction report or it may be acquired by other means (for example ad hoc requests that can take place ex post).

10. These guidelines were considered an interim solution. Regarding the scope of the transaction reporting obligation, CESR committed to launch a review of them after there had been a year's experience of full operation of the MiFID transaction reporting regime with a view to producing definitive guidance in this area which aims at converging practices between CESR members.

11. To this end, CESR launched a Call for Evidence on 3 November 2008 (Ref. CESR/08-873), inviting all interested parties to submit their views as to what CESR should consider when conducting the review of the scope of the MiFID transaction reporting obligation.

12. In the responses received, a need for greater consistency of approach to the interpretation and implementation of MiFID was made clear. Respondents to the Call for Evidence requested CESR to include into its review such elements as the harmonisation of the standards for the use of client and counterparty identifiers within a transaction report, the regulatory uncertainty regarding the firms falling under the transaction reporting regime or the need to clarify which transactions on non-EEA exchanges should be reportable.

13. From the responses and internal discussions held within CESR, the existence of significantly different interpretations of some key terminology relating to transaction reporting also became evident.

14. Another issue identified at this stage was the possibility to analyse whether information helping to identify the beneficiary of a transaction should be included in the transaction reporting requirements (the so called 'client-side' reports described in category c) of the Level 3 Guidelines).

15. Jointly with the consideration of the benefits and drawbacks of including such client-side information in transaction reports in order to meet the market monitoring obligations of competent authorities described in Article 25(1) of MiFID, the eventual harmonisation of the standards for the use of client and counterparty identifiers within a transaction report has to be analysed.

16. The following issues are examined in the next sections of the Consultation Paper:
    - Key terminology supporting the concept of transaction reporting, – trading capacity and distinction between clients and counterparties;
    - Factors impacting the collection of client and meaningful counterparty identifiers;
    - Possible standards for client and counterparty identifiers; and
    - Client ID collection when orders are transmitted for execution

17. Some of the proposals in this consultation paper may imply amendments to MiFID and its Implementing Regulation. In those cases CESR plans to submit its technical advice to the European Commission before the end of July 2010.

18. CESR invites comments from stakeholders on this consultation paper. Respondents can post their comments directly on the CESR's website (www.cesr.eu) in the section "Consultations". The consultation closes on 31 May 2010.

2 Key Terminology on Transaction Reporting

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

2.1 Trading Capacity

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

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

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

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

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

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

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

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

26. The third scenario makes supervision of these trades difficult, since they are currently reported in many countries (and exchanged through TREM) as principal trades while their nature is closer to an agency trade, since the initiative to trade and the corresponding order come from a client of the firm.

27. It is worth noting the difficulty in reaching harmonisation on the treatment of transactions covered in the third scenario above as different legislation or practices across Member States results in some CESR members defining such transactions as two separate transactions whilst

other members define them as a single transaction. CESR considers that there are three possible practical solutions to reporting transactions falling in the third scenario described above in a transaction report.

28. Firstly, they can be treated as two separate principal transactions with the counterparty field populated but the client field left empty in both transaction reports.

29. Secondly, these transactions can be represented in a single principal transaction report with both the counterparty and client fields populated. The originator of the transaction should be entered into the client field. It should be noted that with this option, the client field would have to be populated in all Member States. Under the existing legal framework, for those Member States collecting the client ID, a meaningful code must be entered. For those Member States currently not collecting a client ID, the client field could, for instance, be populated with the word “client”. (Please note the discussion later in this document on the use of client ID).

30. A third option is to create an additional trading capacity as these transactions cannot be classified simply as agency or principal. However, a change of the MiFID Implementing Regulation (Annex I, Table 1, Field 5: Trading capacity) is required for this. Like option two above, the “riskless principal” transactions would be represented in a single transaction report with the originator of the transaction being identified in the client field if populated. (Please note the discussion later in this document on the use of client ID).

31. Another topic, different from the trading capacity debate, is the one on trades done through a market-making arrangement. The current possibilities provided for in MiFID do not allow for identifying transactions performed by market makers (liquidity providers, specialists, etc.). Transactions carried out by them have features that may justify marking such transactions in order to differentiate them from ordinary transactions for supervisory purposes. They respond to a commitment by an investment firm to operate in the market with the goal of providing liquidity to a particular security. The market maker or liquidity provider may channel client orders or even operate on own account on the same financial instrument in a particular trading session. There is some interest, from a supervisory point of view, to be able to differentiate trades done in the capacity of liquidity provider and the rest.

32. However, the definition of the activity of market making or liquidity provision should be carefully considered. The aim would be to capture only transactions that respond to a stable and publicly known arrangement by an investment firm that is committed vis-a-vis an issuer or a trading venue, to provide liquidity in a predefined manner. Therefore, transactions identified as such would not include "discretionary" market making, in the line of the definition included in Article 4(8) of MiFID, but a more stable, public and precise activity regulated by some kind of market rule or practice.

33. Despite the above, taking into account that the number of this kind of arrangements is normally small in each market and that, due to the public nature of those compromises, supervisors are normally aware of the role that a particular investment firm plays on certain financial instruments, CESR is of the view that the addition of some kind of a harmonised flag or indicator by all market makers and liquidity providers at EU level, while useful in some cases, is not essential and could be left to the discretion already available for competent authorities.

Conclusions

34. On the population of the trading capacity field in transaction reports, CESR considers the introduction of a third trading capacity (riskless principal) to be the best and most robust way forward and that the MiFID Implementing Regulation should be amended accordingly. The proposal is based on the fact that the first option would contradict the proposed CESR approach on the collection of client ID (see part 3) and the second option would appear to contradict legislation or practices in many Member States defining the transactions as two separate transactions.

35. On the question of defining a harmonised identifier for transactions conducted under a liquidity provision/market making arrangement, CESR does not see a clear need to propose further harmonisation at this stage.

Proposal

36. CESR suggests introducing a third trading capacity: riskless principal.

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?**

2.2 Client and Counterparties

37. Under the existing EEA transaction reporting framework, the terms "client" and "counterparty" and how they are distinguished are particularly important, as there are two separate fields in a transaction report for these elements and any confusion may result in competent authorities (CA) misunderstanding whether the parties have bought or sold. This is because the buy/sell indicator in a transaction report (i.e. Field 4 in Table 1 of Annex 1) indicates the action of the entity in the client field – the entity in the counterparty field (i.e. Field 20 of Table 1) has actually taken the opposite action to that indicated by the buy/sell field.

38. Article 4(10) of MiFID provides a definition of client for the provision of investment services ("client means any natural or legal person to whom an investment firm provides investment and/or ancillary services"). However, from a transaction reporting perspective, a client can be identified in two ways in a transaction report:

- In the counterparty field (Field 20), where the investment firm is operating in a principal capacity; or
- In the client field, if required locally, where the investment firm is operating in an agency capacity.

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

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

40. This is illustrated in the following examples:

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

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

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

3 COLLECTION OF THE CLIENT IDENTIFIER/MEANINGFUL COUNTERPARTY IDENTIFIERS

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

3.1 Legal framework

42. Article 13 of the MiFID Implementing Regulation and its Annex I set out the content of the transaction reports that investment firms which execute transactions in financial instruments admitted to trading on a regulated market have to report to their competent authorities.

43. In addition to the data set out in Table 1 of Annex I, Article 13(3) of the MiFID Implementing Regulation permits Member States to require additional information than that specified in Table 1 of Annex I. Moreover, Article 13(4) of the MiFID Implementing Regulation gives Member States the possibility to require transaction reports to identify the clients on whose behalf the investment firm has executed the transaction. This option derives from MiFID, as the reporting of client identifier is not required in Article 25(4) of MIFID.

44. This legal flexibility allows Member States to perform their market monitoring and supervision in different ways: either by requiring a systematic reporting of additional information including the client ID or acquiring it on an ad hoc basis, when a trade deems to be suspicious. It takes into account the different practices, structures and sizes of the markets of the Member States.

3.2 CAs' Policies on Collecting Client Identifiers

45. The different rules adopted with respect to client ID collection in the EEA Member States can be summarised as follows: in 19 out of 29 Member States, client information is required in transaction reporting. Therefore a broad majority (more than 65% of CESR members) already request client information in transaction reporting.

46. Of the 10 CESR members which do not currently require client information, some are considering whether to request client information in the near future.

47. Where the client is an investment firm/credit institution, most CESR members that request client information require a BIC code. If a BIC code does not exist, the reporting firm should, in most Member States, use a unique and consistent internal reference code. In two Member States (Germany and Austria), the investment firm/credit institution can choose between certain options such as a BIC code, a unique code for the firm determined by CA/National Bank or other types of local identification codes, for example stock exchange ID or banking routing number.

48. Where the client is not an investment firm/credit institution, most CESR members that request client information require a unique (format free) client code (together with the BIC code of the reporting firm) on the level of the investment firm (e.g. UK). Three Member States (Germany, Austria and Sweden) request a unique (format free) client code on the level of a securities account. In that case, a client with more than one securities account will have different client ID's. Some Member States (Norway, Spain, Portugal, Czech Republic and Malta) use a unique identification number, for example: taxpayer number, personal identity number, business enterprise organisation number, identification number assigned by the National Bank or name of the party entering into the transaction.

49. Three different levels of uniformity are currently used for clients who are not an investment firm/credit institution:

   a. Unique identification number independent of the investment firm/credit institution (for example taxpayer number);

   b. Unique identification number on the level of the investment firm/credit institution; and

   c. Unique identification number on the level of a securities account (for example the bank/securities account number)

50. Most Member States currently request the second option.

3.3 Advantages and disadvantages of collecting client identifiers

51. Many of the arguments for collecting, or not collecting, client identifiers can equally be applied to collecting identifiers for counterparties that are not investment firms, regulated markets, MTFs or central counterparties. So references to client identifiers in section 3.3 and 3.4 should be taken to include entities that might otherwise be identified in the counterparty field as "customer/client".

3.3.1 Benefits of collecting client/counterparty identifier

52. All the competent authorities that collect client IDs currently place great value on the input they provide for market surveillance purposes and rate the usefulness of client IDs as very high.

53. The main purpose of collecting transaction reports is to help CAs meet the obligations of MAD. To meet these obligations, many CAs consider that it is essential to identify the initiator or beneficiary of a trade within the transaction report to enable the detection of market abuse and to protect the integrity of the markets. For many markets, this cannot be done simply by collecting reports on transactions made by investment firms transacting directly with an execution venue. Supervisory signals at firm's level have proved much less precise and much less useful for supervisory purposes than those based on client data.

54. Member States where client ID is regularly collected have seen a decrease in the likelihood of false positives (considering suspicious at firm's level what would be a non-suspicious set of trades at client's level) and false negatives (considering as non-suspicious certain trades that, when attached to a particular client, were clearly suspicious). Without a client identifier, it would be impossible for the CA to deduce certain information from the transaction reports without ad hoc requests, which, in turn, increases compliance costs for firms and CAs. Therefore, client IDs can improve the efficiency of supervision.

55. Category c) in the current CESR Level 3 Guidelines essentially offers CAs the choice to collect client identifiers as part of the transaction reports or collect them on an ad hoc basis. For many markets it is not practical to collect client information on an ad hoc basis as the CA may collect up to seven million transaction reports a day. The CA might end up sending huge and onerous requests to firms for information when further client information would have clearly shown that nothing suspicious had transpired. This burden comes as a cost to the firms and can be upsetting for them if they have already provided client identifiers to help CAs detect truly suspicious transactions.

56. It is important to note that this process can slow down the speed and efficiency of any investigation. Additionally, the ability to immediately identify suspicious client transactions or, just as importantly, to identify certain transactions as non-suspicious, significantly reduces the burden on the CAs, as well as the firms from which information is being sought. Increasingly, transactions are being carried cross-border. In such an instance, suspicious transactions of a firm based in another EEA Member State which does not contain client-identifying information may lead to a request by the investigating CA (the investigating CA) for assistance to the CA in another country (the assisting CA). This will then, dependent on the procedures of the CA, lead to a request by the assisting CA for information from the relevant firm, to be provided within a specified period of time, typically 10 to 15 days. The request will then be answered and the response provided to the assisting CA who will in turn pass the information along to the requesting CA. This process typically takes between three and four weeks and often results in the firm identifying yet another firm as the client for whom the transaction was carried out when in fact the true beneficial owner of the securities is a client of the second firm. This can lead to an additional request for assistance in an effort to pinpoint the true beneficial owner. With the client-identifying information readily available, this initial step or steps can be rendered unnecessary and can thus result in substantial savings of both time and resources for the requesting CA as well as for the firm and the assisting CA. Due to the large number of

market moving events, it is particularly valuable to pinpoint the suspicious accounts of interest as soon as possible.

57. Client identifiers are also useful as they enable profiles of clients' behaviour to be developed in an automatic way. For example, we might find that a seemingly suspicious client actually trades thousands of times a year and loses money as often as he profits. Conversely, we might find that a client always profits from his transactions or always makes profitable transactions ahead of events involving a certain party. This advanced intelligence is totally dependent upon client and counterparty identifiers.

58. Since CAs are obliged to collect counterparty identifiers (at least for investment firms) it may appear inconsistent that they do not collect client identifiers for agency transactions as well. Many CAs view agency transaction reports received from other CAs without a client identifier, or principal transaction reports with the counterparty identified as "customer/client", as additional "noise" that actually detracts from their ability to focus on truly suspicious transactions.

59. Short selling has become an increasingly important topic and many CAs have implemented new regulations to limit or force disclosure of this activity. It is impossible to police such regulation through the identification of investment firms alone and many CAs have noted that many of the parties involved in short selling are hedge funds outside the EEA. The use of client identifiers in transaction reports would undoubtedly help CAs police their short selling rules.

60. Many firms and CAs have undertaken considerable expense in providing these identifiers and building systems to take full advantage of the information provided. If the harmonisation of standards resulted in an agreement not to collect these identifiers, it would result in significant wasted costs to firms and regulators that currently require them.

61. Costs of ad hoc requests by CAs to firms to gather client IDs would shrink significantly if these were routinely collected and reported.

62. Summarising, the collection of client-side information in transaction reports is extremely valuable as a large element of suspicious market behaviour can be detected based on client trading patterns (as well as reporting firm trading patterns). It undoubtedly allows authorities to reduce the amount of additional requests sent to firms, though not eliminating them completely. Without client identifiers, the transaction reports may offer little additional value to trade reports for market monitoring. It should also be noted that attempts to spot suspicious transactions only by the reporting firms is seriously compromised by the fact that it is unclear from a principal transaction whether it was conducted by the firm as a proprietary account or as part of client facilitation.

Question 3: Do you agree with the above technical analysis?

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

3.3.2 Disadvantages of collecting client identifiers

63. It should first be noted that the collection of client identifiers is not a prerequisite for effective market supervision, as some CESR members have in place surveillance systems and methods with proven records in terms of market abuse investigations and sanctions whereby the client identification is obtained in an ad hoc way, when needed.

64. The present variety among CESR members in requirements to collect client identifiers leads to the following problems, which were also identified by some respondents to the Call for Evidence.

65. In situations where multiple legs in a chain of transactions have to be reported in order to provide the information on client ID, it results in additional records in the TREM system that can (in some cases) be deemed redundant.

66. The introduction of systematic collection of the client ID would mean additional costs (mostly one-off, both for firms and CAs) in the 10 Member States that are currently not collecting it. In fact they would have to adapt their reporting systems accordingly, bear additional

administrative workload linked to the input of the client ID and, in some cases, extract the correspondent legs in order to reconcile the information related to the same transaction (for example, as mentioned above, when multiple legs in a chain of transactions have to be reported in order to provide the information on client ID).

67. Moreover, these new costs could be passed on to investment firms' clients, typically with a relevant share of retail investors in those Member States that at present time are not collecting client IDs.

68. In case information on the ultimate client is required to be included in transaction reports on a general basis, attention will have to be paid to investment firms outsourcing transaction reporting to a third party or relying on the waivers provided for in MiFID because this information is not available to the latter or is subject to other conditions.

69. Finally, it should be noted that the provision of the client ID to other competent authorities through TREM should be closely analysed from a legal point of view and especially with regards to legislation on data protection (see also section 5).

Question 5: Do you agree with the above technical analysis?

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

Conclusion

70. The provision of client identifiers and meaningful counterparty identifiers could lead to greater efficiencies in market surveillance and the detection of market abuse. The vast majority of CESR members aim, from a surveillance perspective, at increasing the accuracy of the information on clients and exchanging it on a regular basis, since their experience proves this information to be extremely useful for surveillance activities.

Proposal

71. CESR is considering requesting the European Commission to amend MiFID and its Implementing Regulation in order to make the collection of client ID and (thus) meaningful identifiers for all counterparties by competent authorities mandatory within the framework of the upcoming review of MiFID.

Question 7: Do you agree with this proposal?

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

4 STANDARDS FOR CLIENT AND COUNTERPARTY IDENTIFIERS

72. CESR consulted on the standards for many of the fields identified in Annex I, Table 1 of the MiFID Implementing Regulation in 2006 (Ref. CESR/06-648b), on the basis of which it was decided that the BIC should be used to identify investment firms in the counterparty field and the client fields (if available and if required by the CA). Decisions on identification codes for regulated markets, MTFs and entities acting as central counterparty were made as well (it was decided to use MIC codes for regulated markets and MTFs and BIC codes for central counterparties).

73. However, BICs are not available for all entities and there is no universally agreed standard identifier to be used for entities such as legal or business entities and natural persons.

74. Undoubtedly, a universal code to identify all entities and persons would be preferable to firm specific client codes as parties can have multiple accounts across many firms, either within the same Member State or in different ones. Unfortunately, such a code does not currently exist and many organisations have discovered the futility in trying to implement such a coding scheme. Indeed, when drafting its Level 2 advice in 2005, CESR already identified this issue for client/customer identification. CESR considered that it was not in a position to propose the use of a unique, European-wide code for a client/customer identification by every investment firm reporting a transaction, considering, first, the technical and cost-related aspects of building

from scratch such a pan-European identification code and, second, the political sensitivity of this issue.

75. As already described above in the previous section, when implementing the MiFID reporting obligations, some CESR members that request a client identifier required in their local reporting a unique identification number independent of the investment firm/credit institution to be used. For example, such codes can be existing national standards like the taxpayer number, the personal identity number or the business enterprise organisation number. Some other CAs have also tried to go beyond the firm level by requiring the client name in addition to an internal code set by the investment firm or a national ID code .

76. From a technical point of view, using such coding schemes may not be a major issue for the regulators as most of the Member States requiring the client identifiers use a format free field in the local reporting system. Similarly, for the exchange of this information between regulators, the current structure of the TREM file is most likely to remain appropriate (a 40 alphanumeric characters field). However, many firms claim that their internal systems will be impacted resulting in implementation costs.

77. Even though the use of a national code for legal or business entities does not raise any data protection issues, the matter may be different for the identification of natural persons. In at least one Member State the collection of national client identification codes within the transaction reports and their processing is subject to national Data Protection Agency approval. Even if such information could be freely exchanged through TREM with regulators from European Union Member States, the possible legal and procedural problems to their exchange with CESR members that are not members of the European Union would need to be analysed.

78. Furthermore, some practical solutions would have to be found if personal identification numbers were used at national level, in particular for dual-nationals or in case of joint accounts.

79. The use of the actual name of the persons or entities alone (without combining it with a code) for client identification purposes is not being considered reliable enough due to risks associated with homonymy and the existence of several possible names (commercial, legal, etc.) for the same entity. However, in those Member States where the names together with codes are collected this has proved to be valuable information. This could be kept even if names were not exchanged through TREM (for data protection reasons) and remained at the local CA, in case the investigating CA requested the former more detailed information (names) about particular suspicious transactions.

80. Implementing a code type as universal as possible, and at least beyond the investment firm level, would enable CAs to operate more efficiently, but would have significant cost implications for reporting firms. There might also be legal restrictions for some Member States. However, such a change would have long-term benefits to firms as they would potentially receive fewer information requests from competent authorities.

81. In the view of CESR a possible solution to step from national to pan-European level, at least for natural and legal persons, might be the use of nationality as the leading element[1]. In this case, each Member State could make use of the national code that fits the most its own preferences.

82. Example: Member State A chooses social security number, while Member States B chooses tax payer number. Client Mr. Paul White, of Member State A, has an account both in Member State A and B. Since, his nationality is A, he will be identified with his social security number from A, either when executing a transaction via his account in Member State A or via his account in Member State B.

83. In principle, CESR considers that the ideal solution would be a unique pan-European code for each person (natural or legal) used for transaction reporting. However, due to the inherent technical difficulties arising from the creation of such a code, CESR is of the opinion that unique

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

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

84. Furthermore, European Securities and Markets Agency (ESMA) – the successor of CESR which is supposed to be established on 1 January 2011, could play a role in data exchange on client IDs collected through transaction reports in the future provided that European legislation on data protection is complied with.

Proposal

85. In order to address both the advantages and disadvantages, CESR is investigating the use of a single unique and meaningful identifier for each client or counterparty. Without prejudice of Annex I Table 1 of the MiFID Implementing Regulation and the coding structure already agreed by CESR for investment firms, regulated markets, MTFs and central counterparties, CESR is considering the following guidelines in order to harmonise the standards for the collection of counterparty and client identifiers:

   a. If a BIC has been assigned to the counterparty (irrespective of whether it is an EEA investment firm or not) or to the client (assuming client identifiers were collected), then it must be used as the identifier in the transaction report when exchanged through TREM.

   b. In those cases were a BIC code has not been/could not be assigned, an alternative standard should be used to identify the counterparty or the client.

86. Although there is not yet an agreement on the alternative standard to be used among Member States, CESR believes that it should be chosen between one of those described below, which have been ranked from the “widest” one - at pan-European level- down to the “narrowest” one - at a securities account’s level.

87. CESR is aware that the choice should be made taking into consideration pros and cons of any of them, as described in previous paragraphs, as well as the data protection issue.

88. The standards selected by CESR are the following ones:

   a. Unique identifier at pan-European level, should that code exist at some point in the future, based possibly on any of the following codes:

      – personal identity number;
      – tax payer number (for natural and legal persons);
      – business enterprise organisation number (companies register number);
      – social security number

   b. Unique identifier at national level, such as any of the following codes:

      – personal identity number;
      – tax payer number (for natural and legal persons);
      – business enterprise organisation number (companies register number);
      – social security number;
      – name of the client (as a complement, not substitute, of the above codes)

   c. Unique identifier at investment firm level, such as any of the following codes:

      – internal number assigned by the firm;
      – bank/securities account number (provided there is one account per client)

   d. Unique identifier at securities account level, such as any of the following codes:

- securities account number;
- bank account number

89. In most cases, it is not possible to allow just one type of code in a certain country for reporting purposes since some persons that can be clients may not have such code (children under age, foreign nationals, certain types of trusts, etc.). Therefore, each competent authority would provide clear rules for populating the client ID field, including a list of acceptable codes with a clear preference order attached to it.

90. This design, in CESR's view, would strike a balance between maximum harmonisation of coding rules and their compatibility with laws and available codes in each country. The question of whether to collect the actual name of the client would also be left to national discretion, as long as it complements a certain specific code and is not the sole client ID information collected.

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?

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?

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

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)?

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

5 Client ID collection when orders are transmitted for execution

91. According to Article 25(3) of MiFID, investment firms shall report executed transactions to their competent authorities. Article 5 of the MiFID Implementing Regulation specifies that for these purposes transaction means the purchase and sale of a financial instrument and specifically excludes securities financing transactions, exercise of options or of covered warrants as well as primary markets transactions.

92. The MiFID regime has proven controversial when addressing the supervisory need to monitor client orders that are transmitted by an investment firm to another one for execution. In cases where these orders do not carry along the full client ID, the receiving firm cannot populate the final client ID when reporting to its regulator, since it only knows the identity of the transmitting firm. This may lead to a situation where the competent authority receives reports that provide an incomplete picture of the origin of the transaction, since the transmitting firm may not be obliged to report at all. In these cases, the identity of the real client that initiated the trade is lost for supervisory purposes.

93. The importance of this loss of client IDs must not be underestimated: it means a weaker base for market supervision, more costs for firms due to further ad hoc requests by CAs, misleading supervisory signals (as the transmitting firm appears, unduly, as client) and a general loss of precision in the information exchanges through TREM.

94. Some CESR members have already addressed this issue when interpreting the reporting rules and CESR guidelines. CESR is of the view that it is not acceptable to consolidate a reporting regime without trying to make it as accurate and efficient as possible while maintaining the maximum possible harmonisation to facilitate compliance by trans-national firms. Therefore, CESR is of the view that some changes should be considered to the MiFID regime with that purpose.

95. The goal of the changes would be to ensure that client IDs collected are as accurate and meaningful as possible and that they are not lost for supervisory purposes while orders are transmitted from one firm to another.

96. This issue can be looked at as a legal interpretation debate of the term 'execution' versus 'transmission'. However, since solving this problem would require amending MiFID, CESR has focused the discussion, alternatively, to directly analysing specific changes on obligations of reporting firms to ensure that the information reported is accurate and meaningful for the supervisors. Whether the legal way of reflecting the best alternative is a change of Article 25 of MiFID or a new rule on transmission of orders, can be subject to further study after this consultation.

97. CESR envisages two workable ways of reaching the above mentioned goal:

- Requiring transmitting firms to disclose to the receiving firm the client ID information which is required in the transaction report that the executing firm should send to its competent authority.
- Requiring firms that do not transmit the necessary client ID information to the receiving firm to report the trade to their competent authority, including the client ID and specifying that the report is on an order transmitted to the respective firm.

98. The first option would have the advantage of not creating new reporting obligations for any firm or Member State. On the downside, it is unlikely that firms in certain Member States would agree to pass on client details due to legitimate commercial interests. Client codes can be almost anonymous (internal codes at firm's level) in some reporting regimes but could allow for clear identification of the client in others (tax payer number, name/surname). It is noted also that where the client ID is assigned at investment firm level, it may be necessary for the transmitting firm to pass an additional identifier to the executing firm to ensure that the competent authority can identify the investment firm that assigned the code to the client.

99. The second option carries the merit of protecting the client information from the receiving firm but has the disadvantage that it would require new reporting obligations for those firms (the transmitting firms) in most countries. This could entail some reporting duplication since execution of those orders would also be reported by the executing firm (for instance, the firm that faces the market or platform). However, as long as the reporting of these transmissions is clearly marked as such, there should be workable solutions to avoid double counting and distinguish these reports at the supervisor level.

100. Since both solutions would reach the same goal from a supervisory point of view, it could be left to the choice of the firms to either pass on the client ID information or assume the obligation to report the trade to the CA themselves (or through the other methods allowed by MiFID). This would accommodate different reporting rules existing across the EU, taking into account that client ID codes, as long as there is no single pan-European one, can contain more sensitive information in some jurisdictions than in others. It would also have the advantage of allowing firms to decide depending on the nature of the receiving firm and their commercial interests (for instance, firms that pass an order for execution to another firm in the same group may want to pass the client information onwards for the executing firm to do the reporting to the supervisor).

101. Each competent authority could be given the ability to allow the options described above for the firms in its jurisdiction, or just one of the two alternatives if the structure of the market makes the other one not advisable or workable.

Proposal

102. CESR suggests amending MiFID to enable competent authorities to require that, when orders are transmitted for execution, the transmitting firm either:

- Transmits the client ID to the receiving firm; or
- Reports the trade, including full client ID, to the CA

Question 14: What are your opinions on the options presented in this section?

6 Transaction reporting by market members not authorised as investment firms

100. Article 2(1)(d) of MiFID provides that the Directive does not apply to persons who do not provide any investment services or activities other than dealing on own account unless they are market makers or deal on own account outside a regulated market or an MTF on an organised, frequent and systematic basis by providing a system accessible to third parties in order to engage in dealings with them.

101. The above exemption could potentially create a situation where firms not authorised as investment firms under MiFID fall outside the obligation to report transactions to the competent authority as provided under Article 25(3) of MiFID while trading in financial instruments admitted to trading on regulated markets also when such firms are members of regulated markets or MTFs.

102. Trades conducted by such firms on the regulated market's or MTF's order book contribute to the price formation process for the regulated market or MTF involved. The lack of reporting obligation raises serious concerns in such circumstances as it undermines the general concept of market monitoring and supervision system based on transaction reporting.

103. Reporting of those trades could be done by the members who conducted them but since these are firms exempted from the application of the directive as a whole, this could turn problematic. Alternatively, the trades could be reported to the competent authorities by the regulated markets and MTFs where those trades were finalised. In this case, a specific provision should be added in MiFID.

Proposal

104. CESR suggests amending MiFID by introducing a transaction reporting obligation according to Article 25(3) to those persons that are members of a regulated market or MTF currently falling under the Article 2(1)(d) exemption or, alternatively, by introducing a similar obligation on regulated markets or MTFs that admit these undertakings as members.

Question 15: Do you agree with CESR's proposal on the extension of reporting obligations? If so, which of the two alternatives would you prefer?