



Date: 7 May 2010  
Ref.: CESR/10-510

**CONSULTATION PAPER**

**CESR Technical Advice to the  
European Commission in the  
Context of the MiFID Review:  
Non-equity markets  
transparency**

**Deadline for contributions:** CESR invites responses to this consultation paper by 4 June 2010. All contributions should be submitted online via CESR's website under the heading 'Consultations' at [www.cesr.eu](http://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

The Markets in Financial Instruments Directive (MiFID) came into force on 1 November 2007. It introduced significant changes to the European regulatory framework for equity secondary markets, leaving open to Member States the possibility to extend transparency requirements to financial instruments other than shares according to Recital 46.

CESR has analysed the eventual extension of MiFID transparency requirements to non-equity financial instruments in CESR's response to the Commission on non-equities transparency (Ref. CESR/07-284b) in August 2007 and CESR's report on transparency of corporate bond, structured finance products and credit derivatives markets (Ref. CESR/09-348) as of July 2009.

CESR concluded in CESR/07-284b that at the time there was no evident market failure in respect of market transparency on corporate bond markets and that there was no need of a mandatory pre or post-trade transparency regime. When CESR re-examined the need for additional transparency in the wake of the financial crisis in CESR/09-348, it focused solely on post-trade transparency. In this report CESR concluded that additional post-trade information would be beneficial to the market.

This consultation paper presents possible ways of developing the recommendations in the July 2009 report in the context of the upcoming MiFID Review to be launched by the European Commission in the course of 2010. Since derivatives were not analysed in the past, CESR is also exploring the possibility of a post-trade transparency regime for the most significant subset of these financial instruments: interest rate derivatives, equity derivatives, foreign exchange derivatives and commodity derivatives.

At the request of the European Commission, CESR is also reconsidering whether there is a need for pre-trade transparency for corporate bonds, ABS, CDOs, CDS and the derivatives mentioned above.

### I. Background information

1. In August 2006, the European Commission (Commission) requested CESR to provide initial assistance on non-equity markets transparency by conducting a fact-finding exercise in relation to cash bond markets. CESR provided its response to this request in October 2006 (Ref. CESR/06-599). Having received a further request for technical advice on a range of questions from the Commission in November 2006, CESR prepared its advice on the basis of a public consultation (Ref. CESR/07-284) and an open hearing and published it in August 2007 (Ref. CESR/07-284b). CESR concluded in this advice that it had not recognised an evident market failure in relation to market transparency which would warrant mandatory transparency for bonds. However, it was noted that some re-distribution of the existing transparency information could be useful to help retail participants. At that time CESR recognised that there were market-led initiatives planned in this direction. CESR proposed that the progress of these initiatives should be monitored and their effect evaluated before considering any possible regulatory action.
2. After the publication of the report on "Enhancing Market and Institutional Resilience" by the Financial Stability Forum in April 2008, CESR considered it opportune and timely to review whether the conclusions contained in its earlier technical advice to the Commission remained robust in light of recent market events. A report on transparency of corporate bond, structured finance product and credit derivatives markets (Ref. CESR/09-348) was approved by CESR in July 2009 and subsequently submitted to the European Institutions. It was published together with a feedback statement responding to comments received in a public consultation. In this report, CESR recommended to the Commission to consider the adoption of a mandatory post-trade transparency regime in the context of the future MiFID revision. In this regard, the main conclusions included:

- i) The lack of post-trade transparency is not considered to be a key reason behind the difficulties experienced in the corporate bond markets during the financial turmoil and additional post-trade transparency would not be able to solve the different problems as a singular measure. However, in combination with other measures, additional post-trade transparency would contribute to improving market conditions;
  - ii) Additional post-trade transparency, provided that it be sensibly calibrated to minimise any negative impact on liquidity, might be helpful in restoring market confidence and supporting liquidity in normal times;
  - iii) In delivering an increased level of post-trade transparency to the market a harmonised approach would be preferable to national initiatives taken in this area on the basis of the flexibility allowed by MiFID;
  - iv) The relevant role played by wholesale investors in EU corporate bond markets, characterised by larger traded volumes than those of retail investors is acknowledged. Therefore, consideration should be given to a “targeted” approach which differentiates between the needs of retail investors and small market participants and those of wholesale investors and large market participants.
3. In respect of corporate bonds, CESR recommended that a post-trade transparency regime should have the following characteristics:
  - i) The scope should cover all corporate bonds for which a prospectus has been published (i.e. including all corporate bonds admitted to trading on a regulated market) or which are admitted to trading on an MTF;
  - ii) In terms of the relevant information to be made public, the content of post-trade transparency data should at least include the description of the bond, the price/yield at which the transaction has been concluded, the volume of the executed trade and date and time when the trade was concluded;
4. Regarding ABS and CDOs, CESR proposed that a phased approach should be used so that the regime would gradually apply to all those instruments commonly considered as standardised. The initial issuance size of ABS and CDOs could form a basis for the approach. The following most relevant information should be made public:
  - i) Standardised format of identification;
  - ii) Issuer name;
  - iii) Price at which the transaction was concluded;
  - iv) Volume of the executed trade;
  - v) Date and time when the trade was concluded;
  - vi) Currency;
  - vii) Maturity; and
  - viii) Rating.
5. On CDS, CESR was of the view that post-trade transparency would provide information on the scale of credit transfers and may contribute to increasing liquidity. A post-trade transparency regime should cover all CDS contracts which are eligible for clearing by a CCP due to their level of standardisation, including single name CDS, although there may not yet be an offer for clearing of these CDS by a CCP. The following most relevant information should be made public:
  - i) Standardised format of identification;
  - ii) Issuer name;
  - iii) Price at which the transaction was concluded;
  - iv) Volume of the executed trade;
  - v) Date and time at which the trade was concluded;



- vi) Currency;
- vii) Maturity;
- viii) Rating; and
- ix) Reference entity.

6. For the above mentioned instruments, and as with the transparency regime for equity markets under MiFID, CESR considered that specific attention should be paid to an approach that allows for delayed publication and/or the disclosure without specified volumes if the transaction exceeds a given threshold in order to minimise a potential adverse impact on liquidity.
7. In addition, CESR stated that trade information needs to be made available on a non-discriminatory commercial basis at a reasonable cost and in a manner which is easily accessible by all investors. It was also recommended –in alignment with the existing MiFID requirements- to apply the above approach for post-trade transparency to regulated markets (RMs) and MTFs as well as to investment firms trading outside RMs and MTFs.

## **II. OBJECTIVE AND SCOPE**

8. Recital 46 of MiFID allows Member States to decide to apply the pre- and post-trade transparency requirements to financial instruments other than shares.
9. As a follow-up to the recommendations included in CESR's report on non-equity transparency of July 2009 (Ref. CESR/09-348) and as part of its advice to the Commission on the MiFID Review, CESR intends to determine the mandatory post-trade transparency regime (in terms of thresholds and delays) for corporate bonds, ABS, CDOs and CDS. In addition, and in response to a request by the Commission for information (Ref. MARKTG3/SH/cr Ares), CESR is extending the scope of the exercise to assess the need for pre-trade transparency for the above mentioned instruments and for additional non-equity instruments (i.e. interest rate, equity, commodity and FOREX derivatives). CESR had also decided in December 2009 to extend its work on analysing the need for post-trade transparency to derivatives markets, the importance of which was confirmed by the Commission in its request for information to CESR.

## **III. GENERAL ACCESS TO PRE- AND POST-TRADE INFORMATION**

10. CESR has already undertaken some work to consider the sources of pricing information for non-equity instruments which are available to market participants<sup>1</sup>.
  11. However, in the context of the MiFID Review, CESR is reassessing the current level of pre- and post-transparency available to the market for these instruments as well as considering other instruments for the first time, for example OTC derivatives.
- Q. 1. On the basis of your experience, could you please describe the sources of pre- and post-trade information that you use in your regular activity for each of the instruments within the scope of this consultation paper:**

- a) corporate bonds**
- b) structured finance products (ABS and CDOs),**
- c) CDS,**
- d) interest rate derivatives,**
- e) equity derivatives,**
- f) foreign exchange derivatives,**

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<sup>1</sup> For example, please see in CESR Consultation Paper on Transparency of Corporate Bond, Structured Finance Product and Credit Derivative Markets (Ref. CESR/08-1014) references to ABS [page 53], CDOs [page 54] and CDS [pages 55 and 56].



e) commodity derivatives?

#### IV. CORPORATE BONDS

##### 1. Scope of corporate bonds transparency regime

12. For the purpose of this Consultation Paper, the term 'corporate bond' is defined as a transferable debt security issued by a private corporation to raise capital with a maturity of at least 12 months. CESR is of the view that corporate bonds issued by banks and secured by certain assets (generally mortgages or public sector loans) i.e. 'covered bonds'<sup>2</sup> should be covered by this review. CESR is still considering whether it would be, under certain conditions, appropriate to consider certain covered bonds as structured finance products rather than corporate bonds for transparency purposes.
13. As noted by CESR in its July 2009 Report to the Commission, the proposed scope of a transparency regime for corporate bonds covers those corporate bonds for which a prospectus has been published (i.e. including all corporate bonds admitted to trading on EEA RMs) or which are admitted to trading on an MTF. It is estimated that approximately 43,000 corporate bonds are currently admitted to trading on EEA RMs or MTFs. CESR will undertake further work to verify this figure and to determine the exact population of corporate bonds the proposed post-trade transparency regime will capture.

**Q.2 Are there other particular instruments that should be considered as 'corporate bonds' for the purpose of future transparency requirements under MiFID?**

**Q.3 In your view, would it be more appropriate, in certain circumstances, to consider certain covered bonds as structured finance products rather than corporate bonds for transparency purposes? Please explain your rationale.**

##### 2. Pre-trade transparency for corporate bonds

13. MiFID does not mandate pre-transparency for instruments other than shares admitted to trading on EEA RMs<sup>3</sup>. Whilst operators of organised trading platforms (i.e. RMs and MTFs) are not subject to MiFID pre-trade transparency obligations, they must ensure that there is fair and orderly trading on their platforms. In order to fulfil this obligation they publish information about buying and selling interests on corporate bonds traded on their platforms. However, there are no similar pre-trade transparency requirements for corporate bonds traded outside organised trading platforms, i.e. where the majority of the corporate bond trading takes place.
14. Before the recent market turmoil CESR sought the views of market participants on the availability of pre-trade transparency. Wholesale participants generally seemed to be content with the way in which corporate bond markets worked and their level of access to pre-trade transparency information. However, pre-trade transparency information for small participants, including retail investors, was considered to be less accessible.
15. CESR concluded at the time that there was no evidence of market failure in respect of market transparency on corporate bond markets and that there was no need of mandatory trade transparency (Ref.CESR/07-284b). When CESR re-examined the need for additional

<sup>2</sup> For example German "Pfandbriefe" and Spanish "cedulas hipotecarias" and "cedulas territoriales".

<sup>3</sup> Very few Member States have exercised the option to extend the MiFID transparency regime to other financial instruments under Recital 46 of MiFID. Italy has required RMs, MTFs and systematic internalisers (SIs) to set up and maintain a pre-trade transparency regime for financial instruments traded on systems operated by these trading venues. The trading venues are allowed to design their pre-trade transparency rules, taking into account the microstructure, the nature of the financial instrument, the amount traded and the type of market participants involved with specific attention to retail investors' involvement. Investment firms which are not SIs are not required to provide pre-trade transparency on corporate bonds,



transparency in the wake of the financial crisis in 2008/2009, it focused solely on post-trade transparency, where it concluded that an increased level of post-trade transparency would be beneficial to the corporate bond market, and did not analyse the need for pre-trade transparency.

16. At the request of the European Commission, CESR is now reconsidering whether there is a need for pre-trade transparency for corporate bonds.
17. In general, pre-trade transparency is needed for investors to be able to compare prices and evaluate their trading opportunities and to assist intermediaries in obtaining trading information, thereby helping them to deliver best execution to their clients.
18. The transparency regime set up by MiFID for shares admitted to trading on RMs takes into account the fact that the business, mechanisms and regulation of organised trading platforms are fundamentally different from those of investment firms trading OTC. MiFID promotes the disclosure of as much trading information as possible, taking into account that the same degree of transparency may not be suitable for all business models. MiFID transparency requirements also recognise the different and specific trading needs of market participants.
19. Before advising the Commission, CESR would like to invite interested parties to submit their views on the questions below:

- Q. 4 On the basis of your experience, have you perceived a lack of pre-trade transparency either in terms of having access to pre-trade information on corporate bonds or in terms of the content of pre-trade transparency information available?**
- Q. 5 In your view, do all potential market participants have access to pre-trade transparency information on corporate bonds on equal grounds (for example, retail investors)? Please provide supporting evidence.**
- Q. 6 Is pre-trade transparency efficiently disseminated to market participants? Should pre-trade information be available on a consolidated basis?**
- Q. 7 What are potential benefits and drawbacks of a pre-trade transparency regime for: a) the wholesale market; and b) the retail market? If you consider that there are drawbacks, please provide suggestions on how these might be mitigated.**
- Q. 8 What key components should a pre-trade transparency framework for corporate bonds have? What pre-trade information should be disclosed?**

### **3. Post-trade transparency for corporate bonds**

20. As noted before, CESR concluded in 2009 (Ref. CESR/09-348) that existing market-led initiatives had not provided a sufficient level of post-trade transparency, leading to a market information asymmetry and that an increased level of transparency would be beneficial to the market. CESR also concluded that a harmonised approach would be preferable to national initiatives taken in this area on the basis of the flexibility allowed by MiFID. Such an approach was also preferred by the majority of respondents to the consultation. On this basis, CESR recommended to the Commission to consider the adoption of a mandatory post-trade transparency regime for corporate bonds in the context of the future MiFID revision.
21. To ensure that benefits outweighed costs, CESR also concluded that additional post-trade transparency should be sensibly calibrated to minimise any negative impact on liquidity. At the same time, CESR recognised that a greater level of post-trade transparency than is currently available might contribute to supporting liquidity in normal times and in restoring market confidence.



22. CESR considered it important to reiterate the need that trade information is made available on a non-discriminatory commercial basis at a reasonable cost and in a manner which is easily accessible by all investors. This approach should apply to regulated markets, MTFs and investment firms trading OTC.
23. In terms of content of post-trade transparency, CESR was of the view that the following information was the most relevant information to be made public:
- i) Description of the bond: standardised format of identification (e.g. ISIN code); maturity; coupon; rating; currency; issuer name;
  - ii) Price/yield at which the transaction was concluded;
  - iii) Volume of the executed trade; and
  - v) Date and time when the trade was concluded;
24. In addition to the above information, CESR is considering whether it would be beneficial to include information about the notional value of the corporate bond in the post-trade information to be published.

**Q. 9 Do you think that notional value would be a meaningful piece of information to be made accessible to market participants? Is there any other information that would be relevant to the market?**

25. To minimise a potential adverse impact on liquidity, CESR reiterates its position expressed in 2009 that, as with the transparency regime of equity markets under MiFID, specific attention should be paid to an approach which allows for delayed publication for transactions above certain thresholds. Furthermore, CESR is of the view that it would be appropriate to allow for disclosure without specified volumes if transactions exceed a given threshold. In this respect, CESR considers that any threshold and related time delay should be fixed in a way that adequate consideration is given both to the risks incurred by wholesale market participants when committing capital to provide liquidity to the market and the need to ensure that the market benefits from greater post-trade transparency.
26. As set out in its previous report (Ref. CESR 09-348), CESR considers that when setting those thresholds, the initial issuance size (total value) and/or turnover of a particular corporate bond would need to be taken into account in a similar way as in the case of shares under the existing MiFID regime
27. However, the trading characteristics of corporate bond markets make it challenging to find a single criterion, such as average daily turnover or initial issuance size, which could capture both the volume and frequency of trading in an adequate and consistent manner and as such could be used for calibration purposes,.
28. CESR is therefore proposing a simple calibration whereby the thresholds for delayed publication would be based solely on the size of transactions, as this is considered to be more indicative than the initial issuance size. This approach differs from the MiFID approach for shares admitted to trading on EEA RMs which takes into account the liquidity of the share<sup>4</sup> as well as the size of the transaction<sup>5</sup>.
29. CESR is currently gathering information on secondary trading in corporate bonds from the transaction reports received by Competent Authorities. Preliminary information based on a

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<sup>4</sup> Shares admitted to trading on EEA RMs are divided in 4 liquidity bands.

<sup>5</sup> In its Report (Ref. CESR/10-394), CESR proposed to maintain the existing framework for post-trade transparency of shares admitted to trading on a RM.



sample representing about 20 per cent of the universe of EEA corporate bonds covered in this review indicates that average trade sizes vary significantly from one Member State to another and that the average size of transactions is inversely correlated to the frequency of trading. For instance, less frequently traded instruments tend to trade in higher sizes. CESR will be continuing its internal analysis over the coming months prior to finalising its advice to the Commission on appropriate thresholds and timing of publication but would welcome feedback from market participants on an initial proposal set out below.

**Table 1: Initial proposal for calibration of a post-trade transparency regime for corporate bonds**

| <b>Transaction size (net value)</b> | <b>Information to be published</b>  | <b>Timing of publication</b>      |
|-------------------------------------|---|-----------------------------------|
| Below €1 million                    | Price and volume of transaction   | As close to real time as possible |
| Between €1 million and €5 million   | Price and volume of transaction   | End of day                        |
| Above €5 million                    | Price but no volume (but with an indication that the transaction has exceeded the €5 million threshold) | End of day                        |

30. As indicated in Table 1, CESR is putting forward an initial proposal for consultation which includes the following parameters for real time and delayed publication of corporate bond transactions (considered in terms of net value of the transaction).
31. For transactions below €1 million, CESR is considering an approach whereby the price and the volume of the transaction would be published as close to real-time as possible. If adopted, this proposed approach would ensure that all participants (including retail investors) would have access to real time information about prices and volumes on sizes commonly traded by smaller market participants.
32. For transactions between €1 and €5 million, CESR is proposing to require the publication of the price at which the transaction took place and the volume of the trade executed. This information would have to be published by the end of the trading day.
33. For transactions larger than €5 million, CESR is proposing that the price at which the transaction took place should be published. However, it would not be mandatory to publish the volume of the trade executed, provided that an indication that the transaction has exceeded such threshold is given. This information would have to be published at the end of the day.
34. Currently, MiFID requires transactions in shares admitted to trading on EEA RMs (below large in scale thresholds) to be published “as close to real time as possible”, but no later than 3 minutes after the trading time<sup>6</sup>. The 3 minute deadline should only be used in exceptional circumstances where the systems available do not allow for the publication in a shorter period of time.
35. CESR notes that the trading methodology for corporate bonds is less automated than for equity markets. Therefore the concept of real time publication may differ for corporate bonds. CESR also notes the approach which is adopted by the U.S. mandatory trade reporting system used for corporate bonds (‘TRACE’) whereby transactions must be reported to a centralised reporting facility within 15 minutes from the time the trade was executed. With these factors in mind, CESR is considering what the appropriate benchmark for real-time publication of corporate bonds post-trade transparency information should be.

<sup>6</sup> The three minute deadline is currently being reviewed (see Consultation Paper on CESR Technical Advice to the European Commission in the Context of MiFID Review : Equity Markets, Ref. CESR/10-394).



**Q.10 Do you agree with the initial proposal for the calibration of post-trade transparency for corporate bonds? If not, please provide a rationale and an alternative proposal (including supporting analysis).**

**Q.11 Should other criteria be considered for establishing appropriate post-trade transparency thresholds?**

**Q.12 Given the current structure of the corporate bond market and existing systems, what would be a sensible benchmark for interpreting “as close to real time as possible”?**

## **V. STRUCTURED FINANCE PRODUCTS (ABS AND CDOS)**

### **1. Pre-trade transparency for structured finance products**

36. CESR is assessing whether the existing level of pre-trade transparency in the markets for securitised products is considered to be sufficient. The analysis concentrates on markets for Asset Backed Securities (ABS), including Residential Mortgage Backed Securities (RMBS) and Commercial Mortgage Backed Securities (CMBS), and Collateralised Debt Obligations (CDOs).

37. The financial market turmoil brought to the forefront a number of shortcomings for this market. For example the valuation of structured products and off-balance sheet vehicles proved to be opaque and very diverse in terms of scope and detail. Furthermore, at the instrument level, the information provided to the market by institutions involved in the securitisation process proved to be relatively poor.

#### **a) ABS**

38. Most RMBS, CMBS and other ABS are admitted to trading on RMs and thus are subject to initial and on-going disclosure requirements. However, these products rarely trade on a regulated market and instead mostly trade OTC. Banks are the biggest investor group in the European RMBS, CMBS and other ABS market. Other significant investors are money market funds and fund managers.

39. The degree of secondary trading varies between instrument type and rating. In terms of volume of trading, preliminary indications suggest that secondary trading is likely to be concentrated in the AAA, AA and A tranches. These products are typically traded among a small number of institutional investors and the price discovery mechanism is not subject to stringent transparency requirements. In general, pre-trade transparency is very limited as these products are traded mainly OTC.

40. CESR is considering whether there would be value in extending MiFID pre-trade transparency requirements to ABS. Before advising the Commission, CESR would like to invite interested parties to submit their views on the questions below:

**Q. 13 On the basis of your experience, have you perceived a lack of pre-trade transparency in terms of access to and the content of pre-trade information available in the market for ABS?**

**Q. 14 Is pre-trade transparency information readily available to all potential market participants?**

**Q. 15 Is pre-trade information currently available in the ABS market consolidated and effectively disseminated to those market participants who make use of it?**



**Q. 16 Which potential benefits and drawbacks of a pre-trade transparency regime do you see for the ABS market? If you see drawbacks, please explain how these might be mitigated.**

**Q. 17 Which key components should a pre-trade transparency framework for ABS have? Which pre-trade information should be disclosed?**

**b) CDOs**

41. In general CDOs are complex products, which are most commonly privately placed with very little secondary trading. In terms of secondary market activity, cash CDOs are relatively illiquid products (mostly held on a “buy and hold” basis). There is little information available about underlying assets.

42. As a consequence, pre-trade transparency is offered either through voice, via electronic platforms (Bloomberg, Market Axess, Tradeweb, TLX, etc.) or quotes/runs/axes in electronic format.

43. The financial crisis has made little difference in that respect, with the exception that a significant number of potential buyers have recently decided to retreat from this market. With regard to the synthetic CDOs, they have remained, so far, more liquid before and during the crisis.

44. CESR is considering whether there would be value in extending MiFID pre-trade transparency requirements to CDOs. Before advising the Commission, CESR would like to invite interested parties to submit their views on the questions below:

**Q. 18 On the basis of your experience, have you perceived a lack of pre-trade transparency in terms of access to and the content of pre-trade information available in the market for CDOs?**

**Q.19 Is pre-trade transparency information readily available to all potential market participants?**

**Q. 20 Is pre-trade information currently available in the CDO markets consolidated and effectively disseminated to those market participants who make use of it?**

**Q. 21 Which potential benefits and drawbacks of a pre-trade transparency regime do you see for the CDO market? If you see drawbacks, please explain how these might be mitigated.**

**Q. 22 Which key components should a pre-trade transparency framework for CDOs, have? Which pre-trade information should be disclosed?**

**2. Post-trade transparency for structured finance products**

*a) Scope of post-trade transparency regime*

45. CESR’s report on non-equity markets transparency (Ref. CESR/09-348) concluded in relation to ABS and CDO markets that greater post-trade transparency could assist with valuations and could generally provide greater transparency of market activity to assist with price formation. However, mindful of the current uncertainties surrounding the ABS and CDO markets, CESR was of the view that a transparency regime should be calibrated to ensure that market liquidity is not negatively impacted as a result of introducing increased post-trade transparency.

46. In terms of scope, CESR recommended that the regime should gradually apply to all ABS and CDOs that are commonly considered as standardised, and in terms of implementation, CESR recommended that a phased approach should be used. Therefore, and as outlined in its previous report (Ref. CESR/09-348) CESR proposes that post-trade transparency requirements are introduced, as a first phase, to an initial subset of standardised ABS and CDOs and to gradually extend the post-trade transparency requirements in the following phases to other subsets of standardised ABS and CDOs. CESR is currently developing the details of how the phased approach would work in practice.
47. In addition, a common understanding of the concept of 'standardised' is still in the process of being developed. As a starting point CESR is considering whether it would be useful to include ABS and CDOs for which a prospectus has been published (i.e. including all ABS and CDOs admitted to trading on EEA RMs) or which are admitted to trading on a MTF.
48. Different criteria for the determination of the phased approach for ABS and CDOs are being considered, including:
- a) Rating of the instrument;
  - b) Issuance size; and
  - c) Frequency of secondary trading

**Q. 23 Which of these criteria to determine the first phase of the phased approach do you consider most relevant? Are there other criteria which should be taken into account?**

**Q. 24 Do you have specific ideas on which kind of ABS and which kind of CDOs should be covered by the first phase?**

b) *Calibration of post-trade transparency regime*

49. CESR is currently collecting information on secondary trading in ABS and CDOs, including data necessary to understand average transaction sizes, size distribution of secondary trading and frequency of trading. This information will be used to inform CESR's advice to the Commission on the calibration of the post-trade transparency regime for structured finance products.
50. CESR is minded to apply the framework proposed for corporate bonds to structured finance products, whereby transactions are broken down in 3 different size bands. Each of these size bands would be subject to different obligations in terms of what needs to be published and timing of publication. This would allow thresholds and the related time delay to be set in a way which provides adequate consideration both to the risks incurred by wholesale market participants when committing capital to provide liquidity to the market and the need to ensure that the market benefit from greater post-trade transparency.
51. If the framework for corporate bond post-trade transparency is considered appropriate, then a further question is whether the calibration parameters proposed for corporate bonds (i.e. transaction size thresholds, information to be published and timing of publication as described in Section IV) are appropriate for structured finance products. As noted, CESR is beginning to gather information on secondary trading of structured finance products and preliminary results show a different pattern of secondary trading between corporate bonds and structured finance products. CESR would welcome views of market participants on the proposed framework for post-trade transparency as well as whether the calibration parameters (i.e. transaction size thresholds and delays) proposed for corporate bonds would be appropriate for structured finance products.

c) *Information to be published*



52. In terms of content of post-trade transparency for CDOs, CESR concluded in 2009 that the following is the most relevant information to be made public

- i) Standardised format of identification;
- ii) Issuer name;
- iii) Price at which the transaction was concluded;
- iv) Volume of the executed trade;
- v) Date and time when the trade was concluded;
- vi) Currency;
- vii) Maturity; and
- viii) Rating.

**Q. 25 Do you consider that it would be appropriate to use the same framework for post-trade transparency for corporate bonds and structured finance products? Please elaborate.**

**Q.26 If so, do you agree that the same calibration parameters should be used for structured finance products as for corporate bonds? Or do you think different size and time thresholds should apply?**

**Please indicate whether your response is relevant for both ABS and CDOs.**

## **VI. CREDIT DEFAULT SWAPS (CDS)**

### **1. Pre-trade transparency for CDS**

53. CESR is assessing whether the existing pre-trade transparency for CDS is considered to be sufficient, keeping in mind the importance of this market for reference pricing in other markets (corporate bonds) and the current market situation.

54. As CDS are not securities, there is no secondary market trading of CDS, although the risk position can be onwards sold by way of entering into a legal agreement. As a result the majority of trading takes place OTC, although index CDS and the larger single names CDS with a greater degree of standardisation can lend themselves to electronic trading, which is now growing in Europe.

55. The CDS market is dominated by dealers with 53% of notional amounts outstanding at the end of June 2009<sup>7</sup> held by reporting dealers. Banks and securities firms accounted for 31% of the market, other financial firms accounted for 11% and insurance and guaranty firms accounted for 1%. Non-financial institutions accounted for a further 4% of market share. Dealers, banks and investment firms typically have good access to pricing information through the systems listed below. Buy-side participants have access to bids/offers through intraday dealer run services (see below).

56. In terms of currently available sources of pre-trade information, there appear to be numerous sources of pre-trade transparency for CDS. These include:

- a) dealer runs;
- b) parsing services;
- c) data vendor screens;
- d) broker and single dealer screens; and
- e) bids wanted in comp (BWIC) and offers wanted in comp (OWIC)

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<sup>7</sup> <http://www.bis.org/statistics/derstats.htm>



57. The most widely used and also the source with the greatest coverage are 'dealer- runs'. This is essentially a set of email alerts that dealers send to their client base with bids and offers on the instruments the dealer is making prices in. These quotes are updated throughout the day or in response to changing market conditions.
58. Alongside the bid and offer price the dealer also provides an indication of how good the price is. For example, 'firm' or 'indicative'. Market participants receive multiple dealer runs and the market is highly competitive. Therefore there is an associated reputational risk if dealers do not stand by their prices if approached by the client.
59. Due to the sheer volume of bids and offers received by the market, data vendors have developed technology to collect all the prices from each of the dealer runs that a market participant receives. This is known as a 'parsing service' and it sorts all messages by price. This will essentially be presented back to the client as a stack of all prices per instrument. Next to the best price (and in descending order) the depth of the quote is displayed together with the time and ownership stamp of each price point. The clients will then contact the dealer directly if they wish to execute the order.
60. The number of dealer runs that a market participant receives will vary. Access to pricing is dependent on having a trading line established with the bank. Dealers do not receive pricing information from their competitors. Therefore non-dealer participants have access to a wider source of pre-trade transparency information than dealer participants.
61. There are also a number of MTFs operating in the market who provide information on prices and volumes, as will a number of broker dedicated screens and data vendors.
62. For particularly large and complex transactions, for example portfolio unwinding, market participants approach dealers with a request for pricing on a certain set of assets. This is known as 'bids wanted in comp' or 'offers wanted in comp'. Prices are asked to be supplied by a certain time.
63. There do not appear to be any market-led initiatives which are designed at improving pre-trade transparency for CDS. Instead, the industry is focused on enhancing post-trade transparency where there is perceived to be a greater need for more information.
64. CESR is considering whether there would be value in extending MiFID pre-trade transparency requirements to CDS markets. Before advising the Commission, CESR would like to invite interested parties to submit their views on the questions below:

## Questions

- Q.27 On the basis of your experience have you perceived a lack of pre-trade transparency both in terms of access to and the content of the information available in the CDS market?**
- Q. 28 Is pre-trade transparency information readily available to all potential market participants?**
- Q. 29 Is pre-trade information currently available in the CDS market consolidated and effectively disseminated to those market participants who make use of it?**
- Q. 30 Which potential benefits and drawbacks of a pre-trade transparency regime for CDS do you see? If you see drawbacks, please explain how these might be mitigated.**
- Q. 31 Which key components should a pre-trade transparency framework for CDS have? Which pre-trade information should be disclosed?**



## 2. Post-trade transparency for CDS

65. As outlined in its previous report (Ref.CESR/09-348), CESR is of the view that a post-trade transparency regime should cover all CDS contracts which are eligible for clearing by a CCP due to their level of standardisation. At the moment, the universe of CDS eligible for clearing includes index and some single name (corporate) CDS. In the future, the universe may expand to include a broader range of single name CDS, as well as sovereign CDS.
66. In terms of content of post-trade transparency for CDS, CESR concluded in 2009 that the following is the most relevant information to be made public:
- i) Standardised format of identification;
  - ii) Issuer name;
  - iii) Price at which the transaction was concluded;
  - iv) Volume of the executed trade;
  - v) Date and time when the trade was concluded;
  - vi) Currency;
  - vii) Maturity;
  - viii) Rating; and
  - ix) Reference entity.
67. As for other asset classes considered in this Consultation Paper, CESR is currently gathering data relevant for the calibration of a CDS post-trade transparency regime. CESR is also considering whether the framework described in Section IV for corporate bonds [whereby transactions are broken down in 3 different size bands (i.e. below €1 million, between €1 million and €5 million and above €5 million), each of which with different obligations in terms of the information to be published and the timing of publication] would be appropriate for CDS post-trade transparency.
68. If this framework is considered appropriate, then a further question is whether the specific calibration parameters proposed (i.e. transaction size thresholds, information to be published and timing of publication) for corporate bonds are appropriate also for CDS. One of the potential advantages of using the same parameters would be to align post-trade transparency parameters for CDS with those of the underlying instruments (in the case of single names). However, CESR recognises that it may also be necessary to consider different parameters for post-trade transparency of index CDS contracts because of differences between the structure of the index and single name CDS markets.
69. CESR did not explicitly cover sovereign CDS in previous reports. However, as sovereign CDS are expected, in due course, to become eligible for clearing and therefore fall within the proposed scope of the post-trade transparency regime CESR is assessing whether this is the correct approach and if so whether there are differences between the corporate and sovereign CDS markets which would justify a different approach either in terms of framework and/or calibration parameters (i.e. transaction size thresholds, information to be published and timing of publication). CESR would be interested in market participants' views on the merit of aligning corporate (single name) and sovereign CDS post-trade transparency requirements.
- Q.32 In your view, would the post-trade transparency calibration parameters (i.e. transaction size thresholds, information to be published and timing of publication) proposed for corporate bonds in Section IV be appropriate for a) Single name CDS? and b) Index CDS? If not, please elaborate the reasons and propose alternative parameters (including justifications).**
- Q.33 In your view, should sovereign CDS be included within the post-trade transparency framework for CDS? And if so, should the calibration parameters for single name and sovereign CDS be aligned? If not, please explain why they should be different and propose an alternative approach for sovereign CDS (including justifications).**



## **VII. DERIVATIVES (Interest rate derivatives, Equity derivatives, Commodity derivatives and FOREX derivatives)**

70. CESR is assessing eventual failures and shortcomings in the level of pre-trade transparency for the following derivatives: equity derivatives, interest rate derivatives, commodity derivatives (including energy derivatives) and foreign exchange derivatives.
71. Derivative contracts can either be traded in a public venue, i.e. a derivatives exchange, or privately over-the-counter (OTC), i.e. off-exchange. OTC derivatives markets have been characterised by flexibility and tailor-made products. This satisfies the demand for bespoke contracts tailored to the specific risks that a user wants to hedge. Exchange-traded derivative contracts, on the other hand, are by definition standardised contracts.
72. Derivatives traded on a RM or MTF are subject to transparency requirements as set out by national legislation, regulations or exchange rules. However, there are no such requirements for trading which takes place OTC. Consequently, and in light of the Commission Communication on enhancing the resilience of OTC derivative markets (COM (2009) 332 final), CESR is particularly assessing whether greater price transparency for OTC derivatives might improve the resilience of the financial system and improve market efficiency. However, CESR would also welcome any observations on transparency in exchange traded instruments.

### **Forex derivatives**

73. Foreign exchange (FX) derivatives are closely related to their underlying cash market. The forex market is large and mature. Generally speaking, the further one moves from the spot to the exotic derivative part of the market, the less standardised the market becomes. Most actively traded products are: forex swaps, options, exotics and non-deliverable forwards and options.
74. The forex market is concentrated in terms of products and underlyings. For example, the top three currencies account for close to 80% of the market. Nevertheless, the market has a broad participation although global dealers play an important role. The forex derivative market has been traditionally characterised by large sized trades.
75. Forex products are generally easy to define. There is agreement on market definitions for all product characteristics for a large amount of contracts, including half of the more exotic products. This way, the market presents a high level of standardisation in terms of contract specifications.
76. Retail traders constitute a growing segment of this market, both in size and importance. Currently, they participate through brokers or banks. Algorithmic trading professionals are also active in this market.

### **Interest rate derivatives**

77. Interest rate derivatives account for more than 70 per cent of the global OTC market at a notional value of \$437 trillion at the end of June 2009, 13% above the level six months earlier, according to the Bank for International Settlements. The market is mainly composed of professionals<sup>8</sup>
78. Even though the majority of trades still take place over the phone, electronic trading is increasing, in particular in Europe.

<sup>8</sup> [http://www.bis.org/publ/otc\\_hy0911.pdf?noframes=1](http://www.bis.org/publ/otc_hy0911.pdf?noframes=1)

79. In liquid products, pricing is tight in the major markets for the main wholesale participants. Electronic trading takes place via single-dealer platforms and two multi-dealer platforms: Bloomberg and TradeWeb (operated by Thomson Reuters). Both platforms work based on a request-for-quote ("RFQ") model, enabling users to obtain pricing quotes simultaneously by a given number of dealers. However, it is possible to obtain information on the most important dealers' bid and offer prices from those platforms and market participants use these platforms both for pricing and for trading purposes.
80. Data vendors, such as Bloomberg and Thomson Reuters, provide aggregate data, but there is no obligation to publish all the transactions executed.

### **Commodity derivatives**

81. Commodity derivatives market is a heterogeneous market, although there are some market niches with great standardisation. Market participants are varied and financial investors coexist with non-financial investors whose main purpose is to hedge risk.
82. According to the latest BIS report on "OTC derivatives market activity in the first half of 2009"<sup>9</sup>, the amounts of outstanding commodity derivatives stabilised in June 2009 at 3,7 trillion dollars, after a fall in the second half of 2008.
83. Due to the expansion of their use, the price of commodities and the level of investment rose. New investors have been approaching commodities, with increased interest from pension funds, high net worth individuals and even some retail investors.
84. In the first half of 2008 the increase in the prices and the volatility of some raw materials and energy caused concerns due to their negative implications in the functioning of financial markets. The main concern was that the increase of the financial activity could have caused the increase of underlying prices. Among the questions raised, it was indicated that it would be beneficial that the commodities market could have a greater level of transparency.
85. Additionally, regarding a sub-set of energy derivatives (electricity and gas), the advice of CESR and ERGEG (Ref. CESR/08-998) to the European Commission in the context of the Third Energy Package<sup>10</sup> should be taken into account. In this report it was noted that, since the current level of post-trade information available from platforms is not necessarily uniform across the EU, all EU regulated markets, MTFs, spot exchanges and broker platforms should make public harmonised anonymised post-trade information on standardised electricity and gas supply contracts and derivatives traded on or cleared through these platforms on a continuous (or rolling) basis. The information provided should be on a trade-by-trade basis and should be made public as close to real time as possible, with a maximum delay of 15 minutes, on a non-discriminatory and reasonable commercial basis. It was also acknowledged that any post-trade transparency regime should be calibrated to provide for longer delays for certain types of trades.
86. In this advice, ERGEG also recommended daily publication of information on standardised contracts. This included derivatives irrespective of whether they were MiFID instruments or not. Apart from relevant volume and price information, the publication should include a number of trades and indices describing the structure of the market.

### **Equity derivatives**

87. In terms of size, the equity OTC derivative market is one of the smallest. Traditionally, derivatives traded on exchange have shared the characteristic of being highly standardised

<sup>9</sup> [http://www.bis.org/publ/otc\\_hy0911.pdf](http://www.bis.org/publ/otc_hy0911.pdf)

<sup>10</sup> <http://www.cesr.eu/popup2.php?id=5478>



while structured equity derivative products are much more bespoke or complex with a small, if any, degree of standardisation. The OTC segment has grown in recent years.

88. An OTC equity derivative is usually linked to an equity index, a basket or a single equity and can take the general form of a swap, a forward or an option and can have a simple or a highly complex structure. However, there are other variables such as the variance or the volatility of the equity prices or the equity correlation that can also be considered in the design of an equity OTC contract. Simple contracts are known as 'plain vanilla' and there are other more complex structures such as Asian, barrier, digital, range and podium options.
89. Equity derivative markets appear to be more fragmented than other OTC derivative markets. This is largely due to the existing global fragmentation in the underlying market. Regionalisation is also an important factor. In these instruments, big dealers play a less dominant role and face competition from smaller regional or local entities in all markets.

## Questions

90. As noted above, given the weaknesses exhibited in financial markets during the crisis, CESR has chosen to concentrate on the transparency of OTC derivatives trading. However, CESR would also welcome views from market participants in relation to the transparency of exchange traded instruments.

### 1. Pre-trade transparency for derivatives

- Q. 34 On the basis of your experience have you perceived a lack of pre-trade transparency in terms of access to pre-trade information on a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives and the content of the information regarding these products available in the market?**
- Q. 35 Is pre-trade transparency readily available to all potential market participants?**
- Q. 36 Is the pre-trade information currently available in these markets consolidated and effectively disseminated to those market participants who make use of it? If necessary, please specify your answer by product.**
- Q. 37 Which potential benefits and drawbacks of a pre-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and/or d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.**
- Q. 38 Do you believe that pre-trade transparency would be desirable for some or all types of OTC derivatives (i.e. equity, interest rate, forex and commodity derivatives)? Which key components should a pre-trade transparency framework for any of these above mentioned derivatives have? Which pre-trade information should be disclosed?**

### 2. Post-trade transparency for derivatives

- Q.39 On the basis of your experience have you perceived a lack of post-trade transparency, both in terms of access to relevant information and the content of this information for any of the following markets: a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives?**
- Q.40 Do you believe that additional post-trade transparency would be desirable for all of the above instruments? If not, which ones would benefit from greater post-trade transparency?**



- Q.41 Is post-trade transparency readily available to all potential market participants? Does this vary by asset class?**
- Q.42 Which potential benefits and drawbacks of a post-trade transparency regime for a) interest rate derivatives, b) equity derivatives, c) commodity derivatives and d) FOREX derivatives do you see? If you see drawbacks, please explain how these might be mitigated.**
- Q.43 Which are the key components (e.g. qualitative or quantitative criteria) which should be taken into consideration when designing such a post-trade transparency framework?**
- Q.44 Do you think that a post-transparency regime could have some additional valuable externalities in terms of valuation, risk measurement and management, comparability and other uses in price discovering process on related underlying reference instruments?**