



TECHNICAL ADVICE

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

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Executive Summary

Standardisation

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

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

Legal, process and product standardisation

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

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

Calibration and monitoring of industry targets

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

Measurement and Further Action

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

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

Trading on organised platforms

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

Nature of Proposed Regulatory Action

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

national regulators) to ensure their achievement by the industry.

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

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

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

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

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

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

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

Eligibility of products for Organised Trading Venues

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

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

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

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

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

The calibration and monitoring of industry targets

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

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

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

- The targets should be set at a sufficiently ambitious premium to these existing levels in order to effectively encourage increased platform trading;
 - The targets should allow market participants to trade in Eligible Products on an OTC basis in specific circumstances such as non-addressable liquidity and non price-forming transactions;
 - The targets should be drawn up in consultation with the industry; and
 - Where appropriate, the targets should be differentiated by asset class.
- (c) The publication of the targets on the basis of determined objective criteria. ESMA should also have discretion to publish a general statement, at an appropriate juncture, regarding the compliance or non-compliance of the industry with the targets.

Measurement and Further Action

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

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

1. Introduction

1. The financial markets turmoil that started in June 2007 has revealed shortcomings in the management of counterparty credit risk and an absence of sufficient transparency in OTC derivative markets. In order to improve resilience of OTC derivative markets going forward, at its meeting of 25 September 2009, the G20 called for the strengthening of OTC derivatives markets stating that "all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate".
2. In the U.S., legislation has been recently passed to strengthen the safety of derivative markets through standardisation, central clearing and organised platform trading.¹ On July 21st 2010 the Wall Street Reform and Consumer Protection Act, also known as the Dodd-Frank Act, was signed into law. Part of the provisions of this Act enacts that contracts that are eligible for central clearing are also obliged to trade on swap execution facilities or boards of trade. Due to the number of regulations to be approved by SEC/CFTC, it is still difficult to assess at this stage the exact impact of the Dodd-Frank Act.
3. In Europe, the European Commission has outlined in its Communication "Ensuring efficient, safe and sound derivatives markets: Future policy actions" [COM (2009) 563 final] the core lines of the policy actions it intends to take in 2010 to address these problems². The Commission states that in line with the G20 declaration, consideration should be given to ensuring that trades in eligible products take place on organised trading venues, as defined by MiFID. It also foreshadows joint work with the industry to increase the degree of standardisation of legal regimes and processes.
4. To support implementation of the G20 objectives, at the initiative of the Financial Stability Board (FSB), a working group led by the Committee on Payment and Settlement Systems (CPSS), the International Organisation of Securities Commissions (IOSCO) and the European Commission was formed to consider policy options for promoting increased use of standardised products and for developing a clear process to implement at the global level exchange or electronic trading requirements, amongst other subjects. The working group is scheduled to suggest policy options to the FSB in October 2010³.
5. Further work on OTC derivatives, including on standardisation and market transparency, continues through initiatives amongst a number of supervisory and other authorities, led by the Federal Reserve Bank of New York, called the OTC Derivatives Supervisors Group (ODSG), and market participants, currently made up of the so-called G14 major derivatives dealers and a number of buy-side institutions. Since 2005, market participants have set out detailed commitments, together with their timeframes for completion, in a series of letters to the ODSG. The ODSG monitors compliance of the market participants with their commitments. The most recent letter was dated on 1 March 2010⁴.
6. CESR has decided to look into these matters and published a consultation paper (CP) and held an open hearing with market participants to seek views on the topics of standardisation and organised platform trading of OTC derivatives. The open hearing attracted a broad range of interested stakeholders and a lively debate took place on some of the key issues tackled in the

¹ Please note that the Dodd-Frank Wall Street Reform and Consumer Protection Act was signed into law by the US President on 21 July 2010 as public law 111-203. Further details of the U.S. initiatives are discussed in Sections 2.5 and 3.5.

² Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee, the Committee of the Regions and the European Central Bank, *Ensuring efficient, safe and sound derivatives markets: Future policy actions*, 20.10.2009 [COM (2009) 563 final].

³ http://www.financialstabilityboard.org/publications/r_100419.pdf.

⁴ http://www.newyorkfed.org/newsevents/otc_derivative.html

CP. CESR's final report reflects the outcome of both the consultation and the open hearing. It is noted that stakeholders offered differing views depending on their position in the market and the nature of their interests. However, it is also important to highlight that CESR's aim in relation to the topics analysed below is not only to provide benefits for market participants but also to achieve improvements to the resilience of the market as a whole.

7. Fifty eight submissions (including sixteen confidential responses) were received in response to the CP from a range of European associations, investment banks, data vendors, non-financial companies and other interested parties.
8. As a preliminary indication, in the rest of this Technical Advice the term "Organised Trading Venue" is used as an alternative to the term "Exchange Trading", in light of industry feedback that the latter term caused confusion when used in CESR's CP.
9. It is also relevant to highlight that, despite the evident links between the concepts of standardisation, organised platform trading and eligibility for clearing, this report focuses solely on the first two aspects. CESR's work regarding eligibility for clearing is carried out in the context of the Commission proposal for a regulation on OTC derivatives, central counterparties and trade repositories published on 15 September 2010⁵. The proposed regulation is central to implementing the obligation to clear all 'standardised OTC derivatives' as agreed in the G20.
10. This Report is organised as follows. Section 2 describes CESR's position concerning standardisation as a preliminary step on the way to organised platform trading but also includes thoughts on the value of standardisation as such. Section 3 outlines CESR's view on organised platform trading of OTC derivatives.

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

2.1. Background

11. There are three elements to be considered in relation to standardisation:
 - a. Legal uniformity: this includes standard transaction documentation and definitions;
 - b. Process uniformity (automation): this includes straight-through-processing matching, confirmation, settlement and event handling;
 - c. Product uniformity: including standard valuation, payment structures and dates.
12. In the CP, CESR recognised that legal and contract uniformity is the driver to achieving other elements of standardisation and acknowledged that there seemed to be widespread adoption of standard legal definitions and documents in the market. Nevertheless CESR remained keen to understand whether more needs to be done in this area, especially with a view to achieving other elements of standardisation.
13. To that end, the CP discussed the benefits and possible limitations of standardisation together with an assessment of the current degree of standardisation in the OTC derivatives markets. CESR considered the views of market participants in its assessment of the degree of standardisation.
14. CESR also recognised in the CP that bespoke OTC derivatives are often used for hedging purposes by non-financial firms and, as a result, CESR expressed the preliminary view that

⁵ COM(2010) 484/5.

firms should be able to retain the flexibility to customise aspects such as standard valuation, payment structures, payment dates, and so forth for OTC derivative transactions. However, it was considered that this possibility needs to be carefully balanced against the benefits that adoption of straight-through processing and other automated confirmation systems can deliver. CESR was therefore eager to explore what measures could be taken to foster a higher degree of product standardisation based on the firm belief that a wider use of electronic post-trade processes would enhance the resilience of the market.

15. CESR expressed the preliminary view that greater standardisation of OTC derivatives contracts can deliver efficiency benefits to the market, but recognised the role that bespoke products can play in this context.
16. CESR acknowledged the significant progresses made by the industry towards an intensified use of electronic confirmation systems, but considered that there is – depending on the asset class - significant room for further improvement in this area. CESR was therefore considering recommending to the European Commission that it take regulatory action so as to make the use of electronic confirmation systems mandatory.
17. As part of this assessment CESR considered the most appropriate way in which a mandatory requirement might be applied. In doing so CESR committed to take into account the cost implications for all participants and in particular for smaller participants.
18. In the CP, CESR consulted market participants on its assessment of the degree of standardisation and the benefits and limitations of standardisation, paying particular attention to the quantification of those limitations. It also consulted on whether greater standardisation was desirable and what should be the goal of standardisation, and how the industry and regulators could continue to work together to build on existing initiatives and accelerate their impact. CESR further consulted on whether there were obstacles to standardisation which could be removed by regulatory action and where the priorities should be set. In line with its preliminary opinion of recommending the mandatory use of electronic confirmation systems, CESR requested information on the eventual costs of implementing such measure.
19. In preparing this report, CESR has kept track of other initiatives taken at international level, and in particular, CESR considers that its present advice should not be considered in isolation but understood as complementary to the recommendations of other international fora where EEA regulators are involved, such as the FSB. The ODSG initiative should also be taken into consideration.

2.2. Summary of feedback

20. Regarding the question on the desirability of greater standardisation and the goals of standardisation, respondents generally agreed that legal and process standardisation is desirable, but did not see a need for further product standardisation. Many respondents stress that product standardisation should be driven by market needs and priorities. They also indicate that standardisation should not be a goal in itself. Various goals of standardisation were mentioned such as: to increase market efficiency, to reduce legal and operational risks, to increase pre-trade transparency, to increase post-trade efficiency, reductions of systemic risks and ensuring adequate protection for investors.
21. As regards the question on how the industry and regulators can continue to work together, the industry commitment letters agreed with the ODSG were mentioned in many responses. Some responses suggest that the approach taken by EU regulators should build on the existing initiatives or consultations, joint working groups and other forms of partnership. Legislation is

not seen (by some) as an effective way forward because of possible unintended negative consequences.

22. When commenting on obstacles to standardisation that could be removed by regulatory action, some respondents indicated that regulatory action would not help to remove obstacles. Standardisation should be a market led process in their opinion. Others point out accounting rules, overlapping and conflicting regulation, legal and fiscal differences between jurisdictions as examples where regulatory action could be helpful.
23. Regarding mandatory use of electronic confirmation systems, many respondents supported the use of electronic confirmation systems in general, but were opposed to mandatory use of electronic confirmation systems. The costs may be prohibitive for smaller market participants (or market participants who trade OTC derivatives infrequently). Mandatory action was seen as neither desirable nor practicable and would lead to increased costs for all market participants. There was a general agreement that this should be a market-driven development. Almost all respondents indicate that it is difficult to give a quantification of the cost estimate of implementing electronic confirmation systems, but for these respondents costs are however expected to be higher than the benefits delivered by it.

2.3. Policy Recommendation

24. In order to further the objectives of the G20, in relation to the promotion of an efficient and sound derivatives market, CESR proposes that steps should be taken to increase the proportion of OTC derivatives being standardised by asset class.
25. CESR believes that a higher level of legal, operational and product standardisation (including increased use of electronic confirmation systems) can be achieved and would be beneficial for operational efficiency and the reduction of systemic risk. This should be achieved through the development of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described below.
26. The level of the targets needs to be calibrated by asset class, and the scope of the targets defined by reference to the range of firms/institutions that it is desirable to cover. Regulators need to be involved in the process to provide the framework for discussion, set appropriate targets and monitor their achievement. Therefore, CESR recommends the following policy approach taking into account the comments received in the consultation and the regulatory needs identified.

2.3.1. Legal, process and product standardisation

27. CESR agrees that market participants should develop further legal and product standardisation and more automated processes. Acknowledging the response to the consultation, CESR does not recommend mandating the use of electronic confirmation systems, understood as 100% electronically confirmed contracts. However, ambitious targets should be set for an increased and high level of standardisation and electronic confirmations in order to achieve a higher level of straight-through processing.
28. CESR feels that European regulators, with appropriate involvement by ESMA should take part on other global initiatives under way as this would help make significant progress and that EU authorities should also collaborate closely on their contributions.

2.3.2. Calibration and monitoring of industry targets

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

In case the targets set out were not met, appropriate mandatory regulatory action to lead to the achievement of the targets should be initiated.

30. CESR therefore proposes that ESMA on an EEA level has the following tasks building on work of other international initiatives:
- i) Analyse legal barriers to legal and process standardisation as mentioned by respondents to the consultation (e.g. legal, accounting, tax barriers);
 - ii) Develop and set appropriate targets for legal, process (including electronic confirmation) and product standardisation levels per asset class, in consultation with the industry, recognising that in relation to product standardisation there is a balance to be struck between allowing a role for bespoke products for purposes of hedging risk and increased product standardisation for operational efficiency purposes. ESMA should determine the targets to be met, deadlines and deliveries in a transparent manner;
 - iii) Define the scope of the targets by reference to the desired range of firms/institutions and agree on targets with relevant OTC derivatives market participants;
 - iv) Monitor the achievements reached by market participants against the agreed targets;
 - v) Monitor level of standardisation vs. trading in non-standardised products; and
 - vi) ESMA should have the power to decide on the publication of the targets achieved.
31. At this stage, CESR does not have a definitive view on the exact targets that should be reached in each asset class or on the range of firms/institutions that should be covered. However, CESR considers that a sufficiently ambitious approach should be adopted, taking into account the scope of other EU and international measures in relation to OTC derivatives, to ensure that the proportion of standardised OTC derivatives increases.

2.3.3. Measurement and Further Action

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

3. ORGANISED PLATFORM TRADING

3.1. Background

35. In the second part of the CP, CESR considered issues related to the trading of OTC derivatives on organised trading platforms. It included an assessment of the current degree of organised platform trading of standardised OTC derivatives, a part exploring the benefits and drawbacks of 'organised trading' of standardised OTC derivatives, consideration of the characteristics and the level of standardisation necessary in order for a derivative product to be eligible for organised platform trading, an analysis of the concept of 'trading on organised markets' in the EU legislative context and an assessment of existing market-led and regulatory initiatives promoting organised trading of OTC derivatives.

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

3.2. Summary of Feedback

38. As regards the benefits of regulatory action to mandate trading of standardised OTC derivatives on organised trading venues, a majority of respondents opposed (or strongly opposed) regulatory intervention to mandate platform trading. Many respondents cited the crucial and complementary role of OTC execution models, which underpin the ability to effectively hedge risk. Many respondents also question the incremental benefits of platform trading in the context of existing EU initiatives (e.g. transparency in non-equity markets) and the core objective of reduction of systemic risk. In this regard, some respondents considered that organised platform trading may limit the ability of the industry to develop new products and several references were made to the commercial viability of mandatory action in the context of less liquid products which may lead to the withdrawal of execution facilities. In addition, several respondents pointed to the pro-competitive model under MiFID which facilitates innovation, as an appropriate framework. Some respondents however favoured mandatory action, citing the need to overcome inertia in the existing market structure.
39. As regards the question of regulatory arbitrage between the US approach and the European legal environment in terms of MiFID, respondents generally noted the uncertainty regarding the practical application of the US regulations, in light of the rule-setting responsibilities of US regulators that will be necessary to flesh out the detailed requirements (such as in relation to the types of venue that may fall within the relevant definitions). Many respondents supported a high degree of global coordination in principle, to mitigate the risk of regulatory arbitrage – but some note that this principle has a wider application than the US/EU, as there are other potential financial centres to which liquidity may move. Some respondents noted that EU regulators should maintain focus on the core objectives of the review of OTC markets, and the particular characteristics of the EU market structure which are different in certain respects to the US. However, regulatory and legislative developments in other jurisdictions such as the US should be taken into account by CESR to minimise the scope for regulatory arbitrage.
40. Responding to the question on which sectors of the market would benefit from and/or be suitable for (more) organised platform trading, the following market sectors/asset classes were identified as suitable for more organised platform trading: Equity, (single-name and index) CDS contracts, plain vanilla credit/interest rate swaps and equity futures, on-the-run credit indices, ABX indices, currency derivatives, Swaptions, Variance Swaps, plain vanilla long

options. In more general terms it was suggested that products would be especially suitable where they are highly standardised, high in volume and eligible for CCP clearing. However, it was also pointed out that instruments with a lower level of standardisation may also be platform traded and that standardisation is only one factor among others determining the feasibility of organised platform trading.

41. As regards the requirements of ‘organised trading venues’ many respondents were of the view that only platforms meeting all the requirements listed in paragraphs 86 and 87 of the CP would be in a position to meet the goal of improving the stability and efficiency of the market. Some of these respondents claimed that the same rules should apply for the same trading model, and that the application of the requirements in paragraph 86 only would lead to an unlevel playing field. Other respondents stressed that these requirements accomplish a fairer and non discriminatory access to derivative trading. Many other respondents called for the definition of an organised trading platform to be cast as wide as possible to allow the maximum flexibility for the market to gravitate towards the execution method most suited to it. OTC derivatives could benefit from a similar interpretation of the concept of “organised trading” as currently enshrined in MiFID, which reflects concepts for additional types of trading platform⁶. It was stated that mandating or forcing trading on platforms that meet the requirements set out in paragraphs 86 (or 86 and 87) would be likely to significantly damage many product markets. In the market environment, alternative trading models, such as communication networks streaming indicative prices by dealers to clients had been developed which are successful. One respondent did specifically disagree with a multilateral character of the market. In his view, multilateral market may impact risk associated with provision of liquidity to markets. Other respondents elaborated that benefits of multilateral systems appear only in certain cases, not generally. In this view, a multilateral system is not suitable for derivatives because of the bilateral character of contracts and little use of transparency information which disregard counterparty risk.

3.3. Policy Recommendation

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

3.3.1. Nature of Proposed Regulatory Action

43. In order to further the objectives of the G20, in relation to the promotion of an efficient and sound derivatives market, CESR proposes that steps should be taken to incentivise the increased use of organised platforms for the purpose of trading eligible derivatives products.
44. It is proposed that this action takes the form of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described in the sections that follow. Regulators need to be involved in the process to provide the framework for discussion, ensure appropriate commitments and monitor their achievement. In case the targets were not met, appropriate mandatory regulatory action should be initiated to ensure their achievement by the industry.

⁶ Systematic internaliser and a new concept of broker crossing system, according to CESR Technical Advice to the European Commission in the context of the MiFID Review- Equity Markets (Ref. CESR/10-802).

45. On the basis of an appropriate system of targets including appropriate monitoring and regulatory follow-up action, it will not be necessary to mandate trading of eligible derivatives on organised venues at this stage.

3.3.2. The minimum characteristics necessary for a platform to be treated as an Organised Trading Venue

46. CESR considers that further work is necessary in order to determine the range of characteristics that a derivatives venue should possess so as to qualify as an organised trading venue and meet the objectives set forth by the G20. CESR recommends that such work be initiated as soon as possible and stands ready to assist the Commission in this regard. At this stage, CESR sets out the framework within which this further work should be conducted and the initial conclusions which can be reached.
47. CESR considers that the term “organised trading venue” should be defined by reference to a range of functional characteristics that, collectively, will ensure that trading platforms meet the objectives set forth by the G20. Accordingly, a variety of trading methodologies might qualify as organised trading venues, subject to satisfaction of the specific functional characteristics identified.
48. In CESR’s view, it is clear that high standards with regards to market transparency and operational efficiency are, as a minimum, necessary to meet the G20 objectives. Hence, it should not be possible for a trading venue which did not meet these characteristics to qualify as an organised trading venue in this context. The existing market pre- and post-trade transparency standards set out in MiFID for equities should be used as a basis for further discussion of the appropriate trade transparency regime for derivatives, and to set out the benchmark against which these platforms should be measured. Such work should build on existing CESR recommendations in relation to transparency for derivatives products⁷ and take into account the particular needs of participants in derivatives markets. In addition, CESR considers that the incorporation of further functional characteristics into the definition of an organised trading venue will have to be assessed, based on a fuller assessment of their role in furthering the G20 objectives. Such characteristics may include some or all of the following:
- easy and non-discriminatory market access
 - non-discretionary and transparent rules
 - objective criteria for the efficient execution of orders
 - multi-laterality
 - authorisation/regulation and monitoring by competent authorities
 - operational resilience; and
 - surveillance of compliance with the organised trading venue’s rules.
49. As an initial conclusion, it is clear that Regulated Markets and MTFs, as defined by MiFID, are organised trading venues in this context. These trading platforms meet the full range of functional characteristics described above and, accordingly, unequivocally meet the objectives of the G20.
50. In legislative terms, building on the conclusion of paragraph 48, the key objective of CESR’s further work should be to determine whether other trading platforms, in addition to RMs and MTFs, meeting all or part of the requirements set out above, may qualify as organised trading venues. If a concept beyond the RM and MTF definitions was necessary, it is clear in CESR’s

⁷ CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity Markets Transparency (Ref. CESR/10-802).

view that the equities-focused regimes for systematic internalisers and broker crossing systems would not be appropriate as currently formulated.

51. In the context of the global nature of the derivatives market, and market reforms currently being pursued in the US, CESR considers that an additional objective of its further work should be to ensure international level playing field and mitigate the risk of regulatory arbitrage between markets in EEA countries and other financial centres. In particular, the further assessment of which ones of the characteristics set out above should be applicable to the EU concept of an organised trading venue, over and above the core characteristics of market transparency and operational efficiency, should accordingly be informed by the requirements for “Swap Execution Facilities” in the US. CESR notes that further clarification of how the US regime will be implemented should be forthcoming within the next few months, with rules due to be in place by July 2011. In principle, CESR considers that the definition of “organised trading platforms” to be developed in the European context should take into account the criteria defined above for the SEF aiming at the alignment of the regulatory outcomes.

3.3.3. Eligibility of products for Organised Trading Venues

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

3.3.4. The calibration and monitoring of industry targets

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

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

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

- Work should be undertaken to clarify with an appropriate degree of precision, the proportion of business in Eligible Derivatives already undertaken on RMs and MTFs. Targets should be set at a sufficiently ambitious premium to these existing levels, in order to effectively encourage increased platform trading
 - The targets should take into account the possibility for market participants to undertake an appropriate level of business in Eligible Derivatives on an OTC basis, to meet their legitimate needs e.g. non-addressable liquidity and non price-forming transactions;
 - The targets should be drawn up in consultation with the industry; and
 - Where appropriate, the targets should be differentiated by asset class.
- (c) ESMA should be responsible for publishing the targets on the basis of determined objective criteria. ESMA should also have discretion to publish a general statement, at an appropriate juncture, regarding the compliance or non-compliance of the industry with the targets.

3.3.5. Measurement and Further Action

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