

## **Transparency of EU Financial Market Infrastructures**

### **Submission to EGMI group**

**6 April 2011**

#### **1. Introduction**

The TI 2015 strategy identifies improved implementation of anti-corruption programmes in the international financial system as one of its priorities. Priority 2(a) states that TI principles of *transparency, accountability and integrity* will be integrated into the emerging regulations that control the global financial system.

TI's participation in the European Commission Expert Group on Market Infrastructures takes place in this context. We are concerned that the most recent documents that attempt to encapsulate the Group's consensus view have marginalised the issue of transparency or, at best, reduced it to one aspect of the efficient functioning of market infrastructures. The Group's initial discussions had highlighted transparency as a central pillar of any change to the regulation of financial market infrastructures. This paper, in particular the recommendations in section 3 below, reaffirms and elaborates this initial thinking.

#### **2. Transparency is the key to regulation of financial market infrastructures**

One of the features of the recent market crisis was the build up of hidden risk in financial institutions, which not only was substantially unrecognized by the individual institutions, but also was left unmanaged on an aggregate basis by the national financial regulators. In this context the application of "transparency" principles in the governance framework of the market infrastructure can help manage the eventuality of any similar build up of hidden risk in the future. In addition the inclusion of specific "data transparency" measures in the market architecture can build market confidence with respect to the fairness and safety of that market, for example in relation to price discovery.

The integrity of market infrastructures is secured by a combination of data transparency (more and better quality information) and the accountability and governance of the institutions that operate and oversee the infrastructure. Both elements are necessary and will complement each other. Good supervision needs a continuous stream of high quality information, but the integrity of the system will not be guaranteed by the availability of data alone, as recent events have amply demonstrated.

##### *Data transparency*

Market infrastructures have been called the 'plumbing' of the global financial system. They support the safe, transparent and efficient operation of the system and have a crucial role in upholding principles of fair dealing among market participants. They do

this primarily through disclosure of high-quality and timely data and other information that allows investors, issuers, supervisors and the public to accurately assess risk and expose conflicts of interest.

A feature of OTC markets in particular is the extensive use of bespoke or customized contracts with the consequence that price discovery becomes substantially more difficult. The application of transparency measures can help improve the confidence of market participants in the prices quoted for individual transactions and thereby help institutions manage risk positions more effectively.

Specifically, well-regulated market infrastructures can:

- Prevent conflict of interest by improving the amount of information that issuers have on who has an interest in their shares (and other financial instruments).
- Improve the governance of financial institutions by providing timely and high-quality information on risk exposure (this is primarily the role of Trade Repositories (TR)).
- Improve the governance of the financial system as a whole by providing timely and high-quality information to supervisory bodies (central banks and other regulatory authorities; colleges of supervisors).

Achieving these objectives will reduce the scope for insider trading, fraud and corruption in financial institutions and the system as a whole

#### *Accountability and governance of FMIs*

The movement of much of the market in standardised OTC derivatives toward central counterparties (CCP) and exchanges envisaged by US and EU legislation means that these institutions will themselves become significant centres of risk within the financial system. The systemic risk posed these arrangements means that such institutions should demonstrate state of the art corporate governance and compliance management systems (CMS) to allow stakeholders – market participants, shareholders, employees, supervisors and the public – a deeper insight into the quality of management and business conduct. The prudential supervisory arrangements for such institutions should also be robust and the relevant public authorities well-resourced.

### **3. Recommendations to improve the transparency, accountability and integrity of financial market infrastructures**

#### *(i) Data transparency*

1. A Trade Repository (TR) should provide a consolidated view of market participants' positions.
2. A TR should receive high quality, detailed data about any derivative contract as well as the number and type of trades with non-rated counterparties. The information gathered by trade repositories should be available to both regulators and market participants.

3. A TR should provide data in line with regulatory and industry expectations to relevant authorities and the public, respectively, that is comprehensive and at a level of detail sufficient to enhance market transparency and support other public policy objectives. Such data should be centralised, comparable and coordinated. Where data is not available 'off-the-shelf', regulators may need to become involved in data creation (for example, proposals to create a Legal Entity Identifier (LEI)).
4. A TR should have effective processes and procedures to provide data to relevant authorities in a timely and appropriate manner to enable them to meet their respective regulatory mandates and legal responsibilities.
5. A TR should have robust information systems that provide accurate current and historical data. Data should be provided in a timely manner and in a format that permits it to be easily analysed.

*(ii) Governance and integrity of FMIs*

1. A Financial Markets Infrastructure (FMI) should build the appropriate integrity infrastructure into business operations. This includes:
  - Robust risk assessment and risk mitigation procedures;
  - Adequately resourced risk management personnel that are fully integrated into the organisation's governance,
  - Strong, effective and monitored anti-corruption systems,
  - State of the art corporate governance and compliance management systems (CMS),
  - State of the art auditing and accounting procedures that eliminate off-balance sheet items and ensure appropriate valuation of assets and liabilities;
  - Clear and robust mechanisms for enforcement and sanctions.
2. An FMI should reduce appetite for high-risk strategies by putting in place remuneration policies that reward responsible, sustainable long-term performance or by prioritising the voices of risk management personnel. Board and senior executive remuneration and benefits packages should be made public, tied to sustainable performance and determined by independent, non-executive directors. TI supports the call for shareholder approval of individual board and senior executive remuneration packages (including long-term incentives, stocks, options and pensions).
3. Specific board responsibilities should be designated to oversee corporate governance, risk management and ethical and integrity issues.
4. An FMI should use early-warning systems to counter and monitor risks and alert management.
5. An FMI should provide secure channels for employees to seek advice or voice concerns (whistle-blowing) without fear of intimidation or retaliation. There should be confidential hotlines for this purpose, a supportive corporate culture and tailored trainings.

6. An FMI should adopt clear and comprehensive rules and procedures that are fully disclosed to participants and relevant rules and key procedures should be publicly disclosed.
7. An FMI should disclose clear descriptions of the system's design and operations, as well as the rights, obligations, and risks participants incur by participating in the FMI.
8. An FMI should provide all necessary and appropriate documentation and training to facilitate participants' understanding of the FMI's rules and procedures and the risks they face from participating in the FMI.
9. An FMI should publicly disclose its fees at the level of individual services it offers, as well as its policies on any available discounts. The FMI should provide clear descriptions of priced services for comparability purposes.
10. An FMI should provide a well-organised overview of risks and risk-management processes, in addition to the statement of rules and procedures, to help participants understand risks and manage them comprehensively.
11. An FMI also should disclose its financial condition, financial resources to withstand potential losses, timeliness of settlements, and other performance statistics. At a minimum, an FMI should provide basic data on transaction volume and value. Other useful information that should be disclosed to participants, but typically not to the public, include key highlights of its business continuity arrangements, as well as details of stress tests and other data to help participants understand and manage their potential financial risks from participation in the FMI
12. Market participants entering into derivatives contracts through a CCP or similar institution should commit themselves to a Code of Conduct. This Code will encourage best practices that aim to prevent conflict of interests and comply with laws and regulations, and confidentiality arrangements.

*(iii) Accountability of FMIs*

1. FMIs should be subject to appropriate and effective regulation, supervision, and oversight by a central bank, market regulator, or other relevant authority.
2. Authorities at the national level should publicly disclose the criteria used to identify FMIs that should be subject to regulation, supervision, and oversight.
3. FMIs that have been identified using these criteria should be regulated, supervised, and overseen by appropriate authorities such as a central bank, market regulator, or other relevant body.
4. Authorities should have specific powers or other authority consistent with their relevant responsibilities, including the ability to obtain information and induce change.



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5. Authorities should have sufficient resources to fulfil their regulatory, supervisory, and oversight responsibilities. These resources should be guaranteed over the long-term to ensure they free from political pressure.
6. There needs to be better collaboration between various regulatory and supervisory authorities in terms of sharing data, consistency of reporting standards and centralised aggregation.
7. Authorities themselves need to demonstrate state of the art governance and compliance management systems (CMS) to allow all stakeholders a deeper insight into market supervision, sanctions and corrective actions.