

FESE Views on MiFIR “Non-discriminatory” Access for ETDs Clearing & Trading

Brussels, 15 February 2021

Key issue & request:

- The “Non-discriminatory” Access provisions under MiFIR constitute a serious risk to the EU financial stability and competitiveness as they undermine the ability of market infrastructures to ensure transparent and orderly trading, liquidity and clearing when applied to Exchange-Traded Derivatives (ETDs).
- We very much welcomed ESMA’s no action letter ([here](#)) and the delay of the entry into force of the MiFIR provisions by an additional year, until 4th July 2021, in respect of ETDs. This was included as part of the finalisation of the CCP Recovery and Resolution dossier in order to preserve financial stability in the Union.
- This temporary relief, however, will soon elapse and will not solve the inherent Level 1 risks that the provisions will create, if applied in July 2021.

How to resolve this?

- An additional extension to the exemptions should be adopted to allow for a thorough consideration of the Level 1 framework, particularly on the relevance of maintaining the scope on ETDs.
- In our view, in the upcoming review of the MiFIR framework, ETDs should be removed from the “Non-discriminatory” Access provisions and this short memo summarises the justification for such a move.

The justification for legislative change:

- The provisions would force artificial competition via regulatory intervention, neglecting the fact that the integrated system of trading and clearing ETDs has fostered intra-EU competition and product innovation.
- ETDs function very differently to OTC derivatives. Decoupling trading from clearing would effectively reduce the role of exchanges to the benefit of dealers. This would increase intermediation at the expense of price transparency and orderly trading, which would translate into higher costs for smaller market participants. Clients/investment firms which could not withstand the increase in costs would be prevented from entering new positions, thereby diminishing the overall activity and liquidity of these markets.
- Furthermore, EU infrastructures’ global competitiveness should not be undermined by access requests from within or outside the EU: the “Non-discriminatory” Access provisions were advocated by the UK and the London Stock Exchange which are no longer part of the EU Single Market. With the UK having left the Union, we are concerned that there will be insufficient protection against requests from third countries that are deemed equivalent.
- In addition, once the transitional provision elapses in July 2021, access requests may also be expected from competitors from within the EU which could pose a risk to financial stability and price formation, and cause fragmentation. The EU would be the only jurisdiction in the world to propose such an experiment and there is no use case or business case which would back it up.

The EU27 needs strong and innovative exchange derivatives markets and efficient risk management.

- Over the past 20 years, financial markets have seen strong growth and innovation, and derivatives have contributed substantially to this impressive development.
- Today, exchange derivatives markets are a main pillar in the global financial system, enabling businesses around the world to effectively hedge risks and to invest. Hedging offers a reliable risk buffer against shocks, as proved during the recent Covid-19 crisis.
- Exchange derivatives markets with deep pools of liquidity across different market segments can contribute to economic growth and employment, and act as a strong stabilising force in times of crisis by diversifying sources of finance.
- Exchange derivatives markets are vibrant, offer product innovation both in regional products and in internationally active markets, and, through centralised trading and diversified CCP clearing, avoid excessive risk concentration and optimise price formation.
- ETDs are unique to the regulated market on which they are admitted to trading. This is primarily because regulated markets decide and determine the specifications of their derivative products, together with market participants who will consider the specific characteristics of their ecosystem. This process ensures products are appealing to clients and additionally it caters for increased liquidity and offers an effective way to hedge risk. Exchanges therefore consider ETDs trading and clearing as part of the same process.
- ETDs markets are essential for financial stability. The main liquid ETDs trade continuously in multilateral markets with trading rules aimed at ensuring a fair and orderly market without the intervention of dealers either in the pricing or the market structure, unlike OTC derivatives markets. In OTC derivatives markets, the dealers (i.e. large banks) are able to control pricing, by virtue of being part of the market structure, ensuring that it is dealer to dealer only. In OTC derivatives markets, due to the fragmentation both at the trading and clearing level, there is no robust and independent price formation that the entire market can rely on.
- In the worst financial crises, deeply integrated and liquid ETDs markets act as a refuge market where prices can still be found, and markets can continue operating - a key supporting role for which OTC markets are not equipped. OTC derivatives cannot be relied upon as economic indicators because their prices are directly derived from ETDs prices. If the reliability of ETDs prices is undermined, there is a knock-on effect on instruments such as OTC derivatives and the wider economy.
- If the “Non-discriminatory” Access provisions are imposed on ETDs then some market players may deliberately fragment the EU market to degrade price formation and gain strategic power over the market structure through the use of trading venues and CCPs that they own or control. This could be predominantly the case for US large banks that have strong financial foundations and have surpassed their global competitors. This would mean that the EU would be the only jurisdiction in the world which would move back towards dealer-dominated markets where the investment banks are the gatekeepers of the market and intermediate between buyers and sellers. The US already has become a potential profiteer in the DTO debate between UK and EU, where the only way for market participants to trade certain OTC derivatives could be on US SEFs. The EU needs to be cautious not to hand over more to global competitors, and not to undermine from within.
- It appears counterintuitive to risk breaking Europe’s most liquid and successful markets at the very moment when the EU tries to achieve a strong CMU, enable a policy framework to support the recovery and to strengthen its economic sovereignty by increasing the role of the Euro. Rather, the EU needs to consider strong derivatives exchanges as a cornerstone of price formation, alongside its financial stability and investor protection objectives.

- With mandatory links between CCPs and TVs, and the adjacent increase in complexity and costs resulting from establishing and maintaining connectivity, we fear a risk of concentration of all ETDs clearing activities with only a small number of sufficiently large clearing members. This would effectively reduce intra-EU competition, contribute to concentration of risk in one CCP as well as concentration at clearing member level, and effectively slow down innovation. This runs counter to policy-maker's objective to contain systemic risk.
- The EU has come a long way in increasing competition and transparency across market infrastructures. Exchanges have delivered a multi-faceted solution consistent with the CMU, including support for the international role of the Euro, without the need for any policy intervention.
- The recent "Euroclearing discussion" has highlighted the significant monetary policy and financial stability risks the EU faces in a set-up where systemically relevant clearing volume is left in a third country offshore centre outside the EU jurisdiction and hence outside ECJ jurisprudence.
- While EU regulators have invested significantly to reduce such risks via the EMIR 2.2. framework - accompanied with a temporary equivalence decision for UK CCPs - the EU must be aware that the "Non-discriminatory" Access provisions are running exactly contrary to the current efforts around "Euroclearing".
- The temporary reliefs by ESMA and the co-legislators through CCP R&R were granted on the basis of operational risk arising from the Covid-19 crisis. As highlighted above, however, "Non-discriminatory" Access is an obsolete policy and is now inappropriate for the EU as we focus on improving EU capital markets for the benefit of end investors, regardless of the disruptions caused by the pandemic.
- Furthermore, while EU trading venues and CCPs need to ensure their competitiveness on a global level, it should be noted that no other major jurisdiction, such as the US or Japan, has decided to implement similar provisions for ETDs. Besides the need to address risks to financial stability, competitiveness and innovation - caused by potential access requests from within the Union - the EU should ensure that trading venues in third countries are not allowed to use the "Non-discriminatory" Access provisions to underpin competing ETD contracts based on unlevel playing field conditions, notably relating to central regulatory and supervisory provisions governing transparency.
- As Brexit and the Covid-19 crisis have changed the global realities the EU is facing, FESE strongly urges the Commission to extend the reliefs to allow for a comprehensive Level 1 review. When doing so, the Commission should conduct a proper quantitative financial stability impact assessment as this has never been carried out - and the basis for the qualitative impact assessment has ceased to exist.
- In the Position Paper [here](#), we include arguments in further detail in relation to the issues raised by "Non-discriminatory" Access.