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| Response Form to the Consultation Paper |
| Alignment of MiFIR with the changes introduced by EMIR Refit |

**Responding to this paper**

ESMA invites comments on all matters in this paper and in particular on the specific questions summarised in Annex III. Comments are most helpful if they:

* respond to the question stated;
* indicate the specific question to which the comment relates;
* contain a clear rationale; and
* describe any alternatives ESMA should consider.

ESMA will consider all comments received by **22 November 2019.**

All contributions should be submitted online at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading ‘Your input - Consultations’.

**Instructions**

In order to facilitate analysis of responses to the Consultation Paper, respondents are requested to follow the below steps when preparing and submitting their response:

1. Insert your responses to the questions in the Consultation Paper in the present response form.
2. Please do not remove tags of the type <ESMA\_QUESTION\_AMER\_1>. Your response to each question has to be framed by the two tags corresponding to the question.
3. If you do not wish to respond to a given question, please do not delete it but simply leave the text “TYPE YOUR TEXT HERE” between the tags.
4. When you have drafted your response, name your response form according to the following convention: ESMA\_AMER\_nameofrespondent\_RESPONSEFORM. For example, for a respondent named ABCD, the response form would be entitled ESMA\_AMER\_ABCD\_RESPONSEFORM.
5. Upload the form containing your responses, in Word format, to ESMA’s website ([www.esma.europa.eu](http://www.esma.europa.eu) under the heading “Your input – Open consultations” 🡪 “Consultation on Position limits and position management in commodities derivatives”).

**Publication of responses**

All contributions received will be published following the close of the consultation, unless you request otherwise. Please clearly and prominently indicate in your submission any part you do not wish to be publically disclosed. A standard confidentiality statement in an email message will not be treated as a request for non-disclosure. A confidential response may be requested from us in accordance with ESMA’s rules on access to documents. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by ESMA’s Board of Appeal and the European Ombudsman.

**Data protection**

Information on data protection can be found at [www.esma.europa.eu](http://www.esma.europa.eu) under the heading [Legal Notice](http://www.esma.europa.eu/legal-notice).

**Who should read this paper**

This document is of interest mainly to financial and non-financial counterparties which are subject to the trading obligation under MiFIR and/or to the clearing obligation under EMIR.

**General information about respondent**

|  |  |
| --- | --- |
| Name of the company / organisation | ISDA and FIA |
| Activity | Other Financial service providers |
| Are you representing an association? |  |
| Country/Region | International |

**Introduction**

***Please make your introductory comments below, if any***

<ESMA\_COMMENT\_AMER\_1>

The International Swaps and Derivatives Association (“ISDA”) and the Futures Industry Association (“FIA”), hereinafter called the ‘The Associations’, welcome the opportunity to respond to ESMA’s consultation paper on the Alignment of MiFIR with changes introduced by EMIR Refit, i.e. the misalignment of the Derivatives Trading Obligation (DTO) under MiFIR and the Clearing Obligation (CO) under EMIR.

The Associations strongly support ESMA’s analysis, but furthermore believes that the scope of *transactions* subject to the DTO should be a *subset* of transactions subject to the CO i.e. In order for a derivative transaction to be subject to the DTO, it should, as a precondition, be subject to the CO (i.e. alignment should not be expressed solely in terms of counterparties covered). This would ensure that future amendments to EMIR (and supplementary regulations) would not lead to misalignment, i.e. cross references in MiFIR to specific EMIR articles could be replaced by a broader clarification to this effect. Furthermore, the Associations understands that trading venues and a wide variety of counterparties are working on the basis of such a CO/DTO alignment and wish to continue to do so.

* The Associations believe that, in order for a transaction to be subject to the DTO, it should, as a precondition, be subject to the CO.
* The Associations believe that ensuring this principle will ‘future-proof’ the articulation of the CO and DTO, particularly to the extent changes may, in the future, be made to the scope of the CO.
* The Associations agree with ESMA’s legal analysis of the amendments in relation to financial and non-financial counterparties but believes there plenty of indications from reading of EMIR, MIFIR and related RTS that the co-legislators and the European Commission intended alignment between the CO and the DTO.
* In relation to non-cleared transactions executed on trading venues, the Associations have concerns regarding the pricing of such transactions and non- proportionate administrative burdens for smaller counterparties.
* Lastly, the Associations are generally supportive of a standalone suspension power regarding the DTO, under a pre-defined mechanism and pre-defined criteria (relating to a lack of liquidity in the market, for example).

**About ISDA**

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has more than 900 member institutions from 69 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on Twitter @ISDA.

**About FIA**

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in London, Singapore and Washington, D.C. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry.

FIA's mission is to:

▪ support open, transparent and competitive markets,

▪ protect and enhance the integrity of the financial system, and

▪ promote high standards of professional conduct.

As the leading global trade association for the futures, options and centrally cleared derivatives markets, FIA represents all sectors of the industry, including clearing firms, exchanges, clearing houses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry.

<ESMA\_COMMENT\_AMER\_1>

**Questions**

1. : Do you have any comment on the analysis of the amendments in relation to financial counterparties?

<ESMA\_QUESTION\_AMER\_1>

The Associations agree with ESMA’s legal analysis that the scope of FCs subject to the DTO under MiFIR and the CO under EMIR is not aligned following the publication in the Official Journal of the European Union and entry into force of EMIR Refit.

The Associations believe that the reading of MiFIR, the MiFIR RTS addressing the DTO and the EMIR RTS addressing the CO clearly suggests that the co-legislators and ESMA recognise the appropriateness of ensuring a clear linkage between the scope of application of the clearing obligation and the trading obligation. In order for a counterparty to be subject to the derivatives trading obligation under MiFIR it should also – as a precondition - be subject to the clearing obligation under EMIR.

* Recital 5 of the MiFIR RTS addressing the DTO clearly expresses the linkage between DTO and CO:

*‘Commission Delegated Regulation (EU) 2015/2205*[*(3)*](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R2417&from=EN#ntr3-L_2017343EN.01004801-E0003)*(interest rate OTC derivatives) and Commission Delegated Regulation (EU) 2016/592*[*(4)*](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R2417&from=EN#ntr4-L_2017343EN.01004801-E0004)*(credit OTC derivatives) identify four categories of counterparty to which the clearing obligation applies. In order to accommodate the specific needs of each category of counterparty, a phased-in application of that clearing obligation has also been laid down in those Delegated Regulations. Given the link between the clearing obligation and the trading obligation, the trading obligation for each category of counterparty should only take effect once the clearing obligation for that category has already taken effect.’*

* The European Commission’s intention to legally align the DTO and CO is also articulated in Article 2 of [Commission Delegated Regulation (EU) 2017/2417 (MiFIR RTS addressing the DTO)](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32017R2417&from=EN) and Article 3 of [Commission Delegated Regulation (EU) 2015/2205](https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32015R2205&from=EN) (EMIR RTS addressing the CO) which link the dates from which the trading obligation and the clearing obligation take effect.
* As ESMA points out in Point 30 of the consultation paper, the co-legislators’ intention to align the DTO and CO is further expressed in MiFIR Article 28(2) which clarifies that ‘third-country institutions or other third- country entities that *would be subject to the clearing obligation* if they were established in the Union’ are also subject to the trading obligation. Therefore, EMIR Refit creates a discrepancy between relevant transactions between (i) an EU-domiciled FC+ with an EU-domiciled FC- which are subject to the DTO whereas (ii) transactions between an EU-domiciled FC+ and an equivalent non-EU FC- are not subject to the DTO.

<ESMA\_QUESTION\_AMER\_1>

1. Do you have any comment on the analysis of the amendments in relation to non-financial counterparties?

<ESMA\_QUESTION\_AMER\_2>

The Associations agree with ESMA’s analysis that the cross-reference in MiFIR Article 28(1) to ‘NFCs that meet the conditions referred to in Article 10(1)(b) is incorrect. As the ESMA analysis correctly states, the scope of NFCs subject to the clearing obligation, and the products and asset classes for which they should be subject to the clearing obligation is addressed in the second subparagraph of Article 10(1) and in Article 10(1)(c) of EMIR Refit. As such, the current cross-reference in Article 28(1) should be amended, as it refers to ‘establishing clearing arrangements’ for NFCs where the clearing threshold is exceeded, i.e. the cross reference does not lead to any logical conclusion

The Associations also agree that this misalignment with EMIR should be corrected to ensure the same treatment for NFCs when it comes to the application of the CO and the DTO.

<ESMA\_QUESTION\_AMER\_2>

1. : What is your view on the possible development of on-venue trading for contracts not cleared with a CCP? What are the challenges for the trading venues? What are the challenges for the counterparties exempted from the CO and subject to the DTO?

<ESMA\_QUESTION\_AMER\_3>

The 2009 Pittsburgh G20 Summit agreement concluded *that ‘All standardized over-the-counter derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and centrally cleared, by the end of 2012.’*[[1]](#footnote-2) In the European Union, the trading obligation and clearing obligation aim to implement the international agreement in EU law and, until the publication of EMIR Refit, the CO and DTO were aligned, i.e. only counterparties subject to the clearing obligation could be subject to the derivative trading obligation.

* ***Pricing/CSAs***

The Associations believe that one significant impediment to the theoretical possibility of development of on-venue trading of OTC derivatives subject to bilateral risk mitigation requirements (rather than central clearing) relates to pricing. Pricing of derivative contracts is partially determined by collateral arrangements and, therefore, the same trade transacted between different pairs of counterparties has a different price. For cleared derivative contracts, the collateral arrangements are standardized and known to market participants, i.e. all clearing clients are subject to the same collateral at the CCP and, therefore, the same trade executed between different counterparties would have the same price. For non-cleared derivative contracts, collateral arrangements depend on the individual credit support annex with the trading counterparty, i.e. collateral requirements may vary across individual market participants. Therefore, trading venues may face practical difficulties in pricing non-cleared products and providing a suitable mechanism for aggregating prices. Certainly it is not reasonable to assume that existing functionality designed for cleared products is well suited and easily repurposed for bilateral non-cleared transactions.

* ***Challenges for counterparties exempted from the CO and subject to the DTO***

ESMA has correctly identified in its consultation paper, as expressed in Point 35-38, that one of the main problems with the idea that the DTO should continue to apply to Small Financial Counterparties (SFCs) and Non-Financial Counterparties below the clearing threshold in the asset classes concerned (NFCs-) i.e. they would de facto be scoped back into a clearing obligation that the co-legislators and regulators believe is not proportionate for counterparties who represent such a low level of systemic risk. Contrary to EMIR Refit’s intention to reduce the administrative burdens for SFCs, these counterparties would face significant transactions costs associated with an on-venue execution. SFCs should have the discretion to decide whether they want to centrally clear and trade.

Furthermore, in regard to Point 35, it should be noted that MiFIR was carefully calibrated to allow the most appropriate venue type to develop for particular products. OTC derivatives are traded on OTFs and MTFs, the requirements of which were designed to suit OTC trading, whereas regulated markets are generally better suited to exchange traded derivatives due to the fungibility of these contracts.

* ***Smaller counterparties and liquidity providers would face additional costs and administrative burdens***

The trading of non-cleared contracts on trading venues would also generate additional costs resulting from a) passed through fees resulting from the provision of liquidity, b) the setting up of venue connectivity, and c) account mapping and rulebook reviews among other administrative costs. Liquidity providers would also face an administrative burden as they would need to build and maintain different control frameworks for trades subject to the CO and the DTO.

<ESMA\_QUESTION\_AMER\_3>

1. : What is your view on the arguments exposed above, supporting the status quo i.e. a misalignment between the scope of counterparties subject to the CO and the DTO (G20 objectives, compliance with the DTO less burdensome than with the CO)? Can you identify other arguments?

<ESMA\_QUESTION\_AMER\_4>

The Associations believe that the DTO and CO should be aligned, such that derivatives transaction should not be subject to the DTO unless they are subject to the CO.

In response to the arguments put in favour of status quo as viewed in the CP (i.e. arguments against aligning the DTO and CO):

* **G20 commitments**: The G20 commitment regarding trading of standardised OTC derivatives is itself caveated (‘where appropriate’). We would argue that it is appropriate to remove SFCs and NFCs- from the scope of the DTO for products that they do not have to clear, given that they have been taken out of scope of the CO because of the low levels of systemic risk associated with their activities.
* **Compliance with the DTO less burdensome than with the CO**: Requiring these counterparties to comply with the DTO will de facto scope them back into the CO. Given that these counterparties have been removed from the scope of the CO because the CO was deemed to create a disproportionate burden for them, we don’t believe this argument is sustainable.

<ESMA\_QUESTION\_AMER\_4>

1. : What is your view on the arguments exposed above, supporting the alignment between the scope of counterparties subject to the CO and the DTO (initial policy intention, potential de-facto clearing obligation, limitation of operation burden)? Can you identify other arguments?

<ESMA\_QUESTION\_AMER\_5>

The Associations agree with ESMA’s arguments in favour of re-aligning the DTO and the CO.

* ***SFCs and NFCs- complying with the DTO would be forced to clear their trades***

The Associations agree with ESMA’s analysis that a requirement for SFCs and NFCs- to comply with the DTO would create a de-facto clearing obligation as trading venues in the EU do not widely offer the trading of non-cleared products. This would be contrary to the shared intention of ESMA and Level 1 co-legislators and would create a significant operational burden.

This would negate one of the main policy objectives of EMIR Refit i.e. to make compliance with EMIR more proportionate and less onerous for smaller counterparties.

Other arguments:

* ***Status quo could discourage participation in derivatives business***

The Associations believe that such a requirement could discourage these counterparties from engaging in derivatives activity, with negative consequences for investment via non-derivatives business.

<ESMA\_QUESTION\_AMER\_5>

1. : What is your view on ESMA’s proposal to suggest an alignment in the scope of counterparties between the clearing and trading obligations?

<ESMA\_QUESTION\_AMER\_6>

The Associations agree with ESMA’s proposal, although we would go further, as we are of the view that the DTO should only apply to *transactions* that are (as a precondition) subject to the CO. This would ‘future-proof’ MiFIR such that any changes to the CO (and not solely changes in terms of counterparties covered) would be reflected in the scope of the DTO.

The linkage between the CO and DTO prior to the publication of EMIR Refit should be maintained and the Associations urge the EC and the co-legislators to agree on re-aligning the DTO and the CO in the context of the upcoming MiFID Review.

<ESMA\_QUESTION\_AMER\_6>

1. : What is your view on the necessity to introduce a standalone suspension of the DTO in MiFIR? If you consider it is appropriate, do you have views on how it should be framed?

<ESMA\_QUESTION\_AMER\_7>

The Associations agree with the assessment that ESMA should have a standalone power to request the Commission to suspend the DTO, independent of whether or not the CO has been suspended. The Associations agree that the existing MiFIR DTO suspension mechanism, which requires amending RTS, would not allow ESMA to react swiftly to unforeseeable market disruption. However, in order to give market participants sufficient guidance in relation to the suspension power, the suspension of the DTO should be based on a pre-defined mechanism and pre-defined criteria, which could relate, for example, to a lack of liquidity in the market.

There should not be an assumption that only when the CO is suspended should suspension of the DTO be considered. In this regard, it is worth recalling that while application of the CO to classes of derivatives is a precondition to these being made subject to the DTO, in other respects, the criteria for application of the DTO differ from criteria for application of the CO.

<ESMA\_QUESTION\_AMER\_7>

1. : Have you identified other aspects of the DTO under MiFIR that should be aligned with amendments introduced by EMIR Refit? If so, please explain the amendments to MiFIR that could be introduced.

<ESMA\_QUESTION\_AMER\_8>

As outlined in Answer 7, the Associations believe that ESMA should be able to make use of a standalone suspension mechanism of the DTO, which should be independent of a suspension of the CO. However, as ESMA correctly analysed, any suspension of the CO should be accompanied by a suspension of the DTO. Therefore, it may be helpful to clarify if the suspension of the CO would automatically lead to a suspension of the DTO – in addition to a standalone DTO suspension power.

The Associations believe that a ‘dynamic alignment’ approach should be applied, on a transaction, rather than counterparty level. Unless a transaction is subject to the CO, it should not be subject to the DTO. Otherwise, it will not be suitable or appropriate for it to be executed on OTFs, MTFs or third country venues.

<ESMA\_QUESTION\_AMER\_8>

1. <http://www.g20.utoronto.ca/2009/2009communique0925.html> [↑](#footnote-ref-2)