



# FIA AND FIA EUROPE SPECIAL REPORT SERIES: OPEN ACCESS - CCPs, TRADING VENUES AND BENCHMARKS

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This Special Report is the fifth in the FIA and FIA Europe's series covering specific areas of the European Securities and Markets Authority's consultation process for the implementation of the recast Markets in Financial Instruments Directive II (2014/65/EU) and Markets in Financial Instruments Regulation (Regulation 600/2012) ("MiFIR"), which together are referred to as "MiFID II" and come into effect on 3 January 2017. On 19 December 2014, ESMA published Final Technical Advice to the European Commission (ESMA/2014/1569), together with a Consultation Paper (ESMA/2014/1570), on MiFID II. The Consultation Paper includes draft Regulatory Technical Standards ("RTS") and implementing Technical Standards ("ITS"), which ESMA is required to produce under MiFID II.

This Special Report offers an overview of ESMA's proposals in the Consultation Paper and the draft RTS, as required under Articles 35-37 MiFIR, on the specific requirements for central counterparties ("CCPs") and trading venues to have non-discriminatory and transparent access to one another, and to benchmarks. ESMA set out its initial proposals on these specific technical requirements in its Discussion Paper (ESMA/2014/548), published in May 2014.

## **ARTICLES 35-37 MiFIR**

Articles 35-37 of MiFIR provide that CCPs must clear financial instruments on a non-discriminatory and transparent basis regardless of the trading venue on which a transaction is executed; that trading venues should provide, on request, trade feeds on a non-discriminatory and transparent basis to a CCP that wishes to clear transactions traded on the relevant venue; and, that both CCPs and trading venues be given non-discriminatory access to benchmarks. These Articles also task ESMA with drafting the necessary RTS required to deal with various technical issues surrounding open access. The Consultation Paper's key proposals on these are summarised below.

## **NON-DISCRIMINATORY ACCESS TO CCPs AND TRADING VENUES**

### **1. Grounds for denying access**

Augmenting the Discussion Paper, ESMA's latest proposals in relation to the conditions under which CCPs may refuse access to a particular trading venue are as follows:

- a) Volume of transactions: a CCP may deny access where the reasonably anticipated volume of transactions arising from such access request would create significant undue risks, by exceeding the scalable design of the CCP to such an extent that the CCP cannot adopt its systems so as to deal with the anticipated volume or exceeds the capacity planning of the CCP in a way that the CCP would not be able to acquire the required extra capacity in due time. In line with the requirements of the European Markets Infrastructure Regulation (Regulation 648/2012) (EMIR), ESMA believes that, to do this, CCPs will have to show what capacity they have installed and how and why they cannot acquire the needed capacity in due time so that granting access would leave a significant undue risk that cannot be managed.
- b) Management of operational risk: operational risk and complexity arising from such access will be grounds for denying access to trading venues only where the CCP cannot adopt arrangements to adequately manage those risks such that there would be significant undue risk remaining. Whilst the list is non-exhaustive, the Consultation Paper identifies the following two risks as relevant in this regard:
- i. incompatibility of CCP and trading venue IT systems such that the CCP cannot provide for connectivity between the systems; and
  - ii. the CCP does not have, nor is it able to get in due time, staff with the necessary knowledge, skills and experience to perform its functions regarding the risk stemming from additional financial instruments where these differ from financial instruments already cleared by the CCP.
- c) Other factors creating significant undue risks: a CCP may deny access to a trading venue that wishes for the CCP to clear financial instruments not covered by the CCP's existing authorisation under EMIR and for which it is unable to obtain authorisation. Costs incurred by the CCP in granting access may be grounds for denying access where they are substantial enough to threaten the economic viability of the CCP. A CCP may also deny access if such access compromised its ability to meet its capital requirements under EMIR or created certain specified legal risks, or if there were an incompatibility of CCP and trading venue rules that the CCP could not remedy in cooperation with the trading venue.

MiFIR provides much narrower grounds for trading venues to deny access to CCPs. Incompatibility between the trading venue's and CCP's IT systems could lead to a denial of access by trading venues for CCPs. On undue risks, ESMA considers that costs issues and incompatibility of venue rules, as described in c) above, may equally be grounds for trading venues to deny access. However, in contrast to the rules applicable to CCPs, ESMA does not permit trading venues to deny access on grounds relating to lack of human resources. Trading venues are also not permitted to cite legal risks as a ground to deny access.

## **2. Threat to the smooth and orderly functioning of markets**

National competent authorities (“NCAs”) may deny access if such access would threaten the smooth and orderly functioning of the markets or adversely affect systemic risk, apart from the situations identified in EMIR, where one of the parties is not meeting its legal obligations (or would be unlikely to do so) as a result of granting access; granting access would create significant undue risks for either party in a way that would have a wider negative impact on the market; *and* there is no remedial action that would enable the relevant party to meet its legal obligations with reasonable effort prior to the access arrangement being put in place.

## **3. Grounds for permitting access**

In the Discussion Paper, ESMA considered a list of minimum requirements relating to the necessary terms under which CCPs and trading venues may grant one another access. Following feedback from respondents ESMA proposes to include additional conditions in the terms of any access arrangement, which are now set out in the RTS. Relevant parties will be required also to:

- a) specify the contracts subject to the access arrangements;
- b) specify the cover of one-off and ongoing costs triggered by the access request; and
- c) cater appropriately for claims and liabilities stemming from the access arrangements.

In relation to the fees charged by CCPs and trading venues, ESMA maintains its definitions of “non-discriminatory” and “transparent” from the Discussion Paper. In response to feedback received, ESMA states that the RTS should not specify a catalogue of relevant fees in this context, since it would be misleading and non-exhaustive. The RTS state that the *schedule* of fees and rebates charged by a CCP to clearing members relating to access must be non-discriminatory and transparent. Non-discrimination does not mean homogeneity. With respect to CCPs fees that are charged to a trading venue in connection with an access request, the CCP is permitted to charge different fees and offer different rebates with regard to the same or similar financial instruments, provided that a different basis can be objectively justified. One-off and ongoing costs should also be included in any fees structures.

Under MiFIR, ESMA is required to specify the conditions under which trading venues are entitled to non-discriminatory treatment by CCPs in relation to: the collateral requirements and netting of economically equivalent contracts; and cross-margining of correlated contracts. The Consultation Paper sets out ESMA’s latest proposals on each:

- a) Collateral requirements: CCPs should apply the same margin and collateral methodologies to economically equivalent contracts, irrespective of where they are executed. CCPs should consider contracts as economically equivalent where such contracts do not require the CCP to obtain an extension to its authorisation under EMIR. In addition, any

specific models or different parameters applied to such contracts must be non-discriminatory and based on risk considerations.

- b) Netting: a CCP shall net economically equivalent contracts, irrespective of where the contracts were executed, provided that the applied netting process is valid, binding and enforceable in compliance with the Settlement Finality Directive and applicable insolvency law. Where the CCP considers that the legal risk or basis risk related to a netting process applies to an economically equivalent contract traded on different trading venues is not sufficiently mitigated, the CCP may exclude such contracts from that netting process. Such event shall be considered as a significant change to the CCP's netting process that shall be subject to review by the Risk Committee and the review procedure under EMIR Article 49.
- c) Cross-margining: where a CCP calculates margins with respect to portfolio margining of financial instruments in accordance with Article 41 of EMIR and Article 27 of Regulation (EU) No 153/2013, the CCP shall apply its portfolio margining approach to all relevant correlated contracts irrespective of where the contracts are executed.

#### **4. Notification procedure and calculation of notional amount**

MiFIR allows new CCPs and smaller trading venues to apply for a temporary thirty month exemption from the non-discriminatory access requirements. For trading venues which trade exchange-traded derivatives, the exemption further requires that the annual notional trading volume of such derivatives is below €1,000,000 million, and an extension would be possible if the condition is still met.

The draft RTS set out the proposed notification procedures and forms for CCPs and trading venues wishing to utilise the exemption, together with the allied procedure which NCAs must then adopt to notify ESMA or the CCP college in the event they approve the CCP's or trading venue's notification. CCPs and trading venues will be required to submit a form including identification details and the names and jurisdictions of any trading venues or CCPs with close links to the applicant. Trading venues will also need to provide information on group structures and data on the annual notional trading amount in exchange traded derivatives per asset class and for each venue in the European Union if part of a group. CCPs will have to include the date they were authorised or recognised.

On the calculation of the annual notional amount for exchange-traded derivatives, ESMA confirms that its preferred approach set out in the Discussion Paper has been adopted in the RTS. To calculate the amount, a trading venue must aggregate the notional amount of every transaction in exchange-traded derivatives concluded under its rules every day of the preceding calendar year, and add this to the equivalent calculations for other venues within the group based in the European Union. The RTS provide specific examples for certain types of derivatives and instructions on the calculation required for trading venues which wish to opt-out from the adoption of MiFIR in 2017.

# **NON-DISCRIMINATORY ACCESS TO AND LICENCING OF BENCHMARKS**

## **1. Benchmark information**

MiFIR provides that persons with proprietary rights to benchmarks shall ensure CCPs and trading venues are permitted non-discriminatory access to certain information and methodologies relating to the benchmark, and to licences. The Discussion Paper set out specific complexities surrounding benchmarks and data, including ownership.

Following feedback on the Discussion Paper, ESMA proposes that the specified content of information in the draft RTS should not constitute an exhaustive list to be made available to all trading venues and CCPs. Since benchmarks are heterogeneous, CCPs or trading venues may need to request further information necessary for clearing and trading purposes, which persons with proprietary rights to those benchmarks should provide on a non-discriminatory basis. The draft RTS provide guiding principles on the provision of such information. ESMA further proposes that where a person with proprietary rights does not have access to relevant information or cannot pass such information on to a trading venue or CCP due to non-discriminatory contractual obligations or other legal obligations, the trading venue or CCP shall request such information directly from the third party or parties who own it. Where appropriate, the person with the proprietary rights in the benchmark shall notify the trading venue or CCP of whom they may contact to access the information directly.

## **2. Other conditions for granting access**

In the Discussion Paper, ESMA acknowledged that it is important to balance the regulatory goal under MiFIR of providing CCPs and trading venues with non-discriminatory access to benchmarks against the proprietary rights held by the owner of the benchmark. The person with the proprietary rights should provide the licences, including all necessary elements to form the legal commercial relationship.

ESMA well understands that benchmarks are diverse and that harmonisation on the content of licence agreements or constraining the conditions to pre-determined terms in this area is likely to be detrimental to all parties. Therefore, it proposes that persons with proprietary rights to a benchmark set the conditions for access to the benchmark and may set different ones for different categories of CCP and trading venue, provided such differences are objectively justified and applied in a non-discriminatory and proportionate way. Also, persons with proprietary rights should make the criteria determining identification of different categories of licensees publicly available, so that CCPs and trading venues may then self-assess to which category their activities would correspond and then request to see the conditions applicable to that category. This would mean that persons with proprietary rights to a benchmark will only be required to make the licencing and pricing conditions available to the CCP or trading venue requesting access that would apply to the category to which the CCP or trading venue belongs. The conditions should cover a series of mandatory elements specified in the draft RTS, including: scope of use; conditions of redistribution of information (if allowed); technical requirements; fee and payment conditions; the conditions under which the agreement expires;

the related contingency conditions; governing law and allocation of liabilities. Any modifications to one particular licence which has been agreed bilaterally should be made available to all other licensees in the same category. ESMA recommends that the person with proprietary rights to a benchmark should have discretion to authorise the redistribution of information by licensed trading venues and CCPs. However, should it do so for one entity, others should be able to claim such rights on the same conditions.

### **3. New benchmarks**

MiFIR tasks ESMA to specify the standards guiding how a benchmark may be proven to be new. ESMA set out a number of factors that could be used to assess this in its Discussion Paper. It proposed that any such assessment should vary on a case by case basis with factors being appropriately weighed against one another.

ESMA confirms that it will follow the approach outlined in the Discussion Paper. The Consultation Paper explains ESMA's belief that, whilst specific factors should be considered depending on the type of benchmark being assessed, it would not be appropriate to include an exhaustive list in the RTS and the RTS state this explicitly. The RTS also include a recital providing examples of factors specific to certain types of benchmark.

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