AUTORITÉ DES MARCHÉS FINANCIERS

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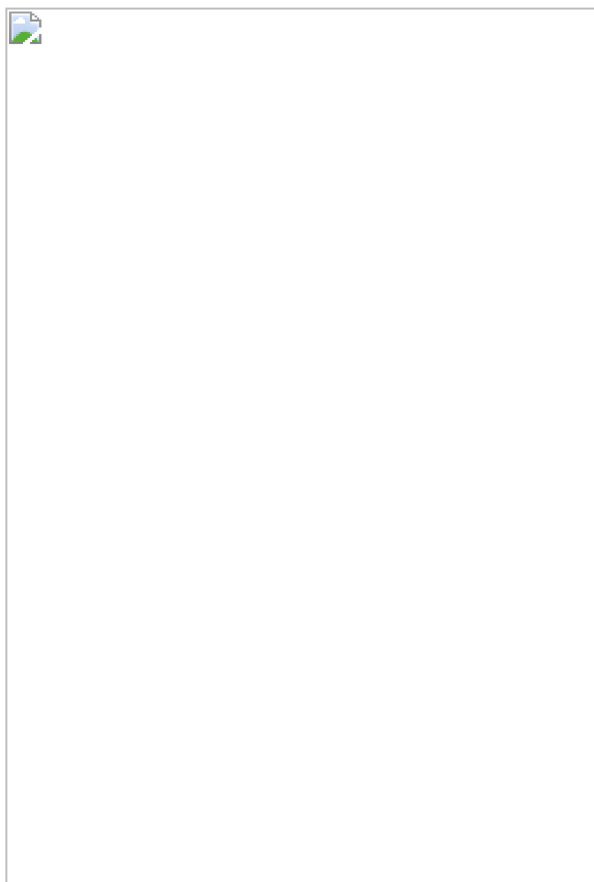
Discours de Robert Ophèle, Président de l'AMF - ISDA's Annual Conference - Londres - 19 septembre 2019 (en anglais uniquement)

Seul le prononcé fait foi

Good afternoon,



It is always a pleasure to be invited to participate in the annual ISDA conference and to have the opportunity to say a few words on some of the challenges the derivatives markets may face in the coming months.

And there are quite a few challenges ahead. You have discussed many of these during the conference, such as the transition to new critical benchmarks, the introduction of the new EMIR framework, or the finalization of the rules in the US - just to name a few.

This afternoon, I will discuss the derivative trading obligation, DTO, in the perspective of the UK's withdrawal from the European Union.

Brexit is a challenge for all market participants;

it is also a challenge for all regulators since we all have to address issues never experimented before.

The European Commission and ESMA have done a tremendous job identifying issues, communicating preparedness notices, and taking action where needed to prevent financial stability risk. I fully support the EU's transparent and rigorous approach.

To some extent, Brexit highlights also the limits of several provisions of our regulations and some issues remain outstanding. These may not present a risk to financial stability but nevertheless are essential for the proper functioning of our markets.

The state of play could appear simple since, due to the onshoring by the UK of all the EU financial regulations, similar provisions are supposed to apply in the UK and in the EU. The situation is actually much more complex, with a risk of regulatory overlap(s), i.e. conflicting requirements, and a risk of regulatory arbitrage; both of which could hamper the proper supervision and orderly functioning of our markets.

To illustrate this challenge, I would like to take a moment to discuss how these questions materialize in the context of the implementation of the derivatives trading obligation.

The share trading obligation, STO, has attracted a lot of attention; Andrew Bailey has expressed his doubts on the relevance of such an obligation putting emphasis on the best execution principle, and the German Ministry of finance rightly proposes to amend MIFIR on its perimeter. The derivative trading obligation has some similarities with the share trading obligation but it has also some differences.

Let us assume a no-deal Brexit with no equivalence granted to UK trading venues by the European Commission; the UK and the European Union will each have their own requirements for trading derivatives. This will automatically raise two questions involving the scope of this requirement:

- What instruments should be subject to each trading obligation and,
- Which entities are concerned by each trading obligation.

Allow me to offer my views on these two matters.

First, let's consider the products subject to the Derivatives Trading Obligation ("DTO")

As a reminder, the starting point of the DTO is the scope of derivatives that are subject to the Derivatives Clearing Obligation. Only those instruments could be subject to the Derivatives Trading Obligation.

The Derivative Clearing Obligation results from the combination of a bottom-up approach when an EU CCP is authorised to clear a new asset class and a top-down approach according to the market analysis performed by ESMA. Ultimately ESMA proposes to the Commission to declare (or remove) the clearing obligation for trades on a class of derivatives according to its level of standardisation, the volume and liquidity of its market, and the existence of reliable information on its prices.

Then, additional criteria based on liquidity, number of market participants and spreads are applied to determine the scope of the trading obligation.

Liquidity criteria are especially tricky to implement in the case of Brexit. While liquidity is currently mainly in the UK for most of the instruments subject to the DTO, it is obvious that Brexit will trigger a shift of part of this liquidity located in the UK. The magnitude - and the direction - of this shift depends partly on the EU's decision regarding the scope of the DTO.

The 8 asset classes currently covered by the DTO are all cleared by an EU 27 CCP and by a UK CCP; 6 are cleared only by one EU 27 CCP while 3- and 6-month Euro IRS's are currently cleared by several CCPs of the EU27. UK CCPs benefit from a transitory recognition with an equivalence expiring end of March next year, but some US, Japan and Hong-Kong CCPs are also recognised CCP for these products. Depending on the decision that will be taken regarding the equivalence / recognition of UK CCPs, the scope of the clearing obligation will have to be reviewed at some point.

Eligible trading venues proposing instruments subject to the DTO include (at the end of July) 20 platforms in the UK and 11 in the EU 27 (4 in the Netherlands, 2 in Spain and 5 in France). The Commission has granted an equivalence to US trading venues (23 Swap Execution Facilities and 14 Designated Contract Markets) and Singapore trading venues (3 Approved Exchanges and 2 Recognised Market Operators). The FCA has already announced that after Brexit it would grant an equivalence to the US trading venues.

It is not obvious that the volumes generated by the EU institutions alone would be sufficient to justify maintaining the current scope of the DCO/DTO after Brexit; the case of Sterling IRS's is for example extremely questionable; the case of USD derivatives is relatively open while the case of EUR derivatives is more straightforward.

If the EU institutions no longer have the capacity to cover their positions in a very liquid market due to the location imposed by the DTO, they will not be able, for example, to propose competitive offers to their clients which will, for example, lead some of the latter to

relocate their hedging operations. By thus maintaining a too broad scope of trading obligation could penalise EU financial institutions and most of their clients. This is not a matter of negligible importance.

Now let's turn to the scope of the counterparties concerned by the DTO and more specifically, how third country branches should be treated.

Since they do not have a legal personality, branches may be subject to the same requirements as their head office, but it may also be decided to apply to them the host country's regulations so as to place them on an equal footing with the local competitors.

In the case of the DTO, some consider that the EU regulation points towards the home country requirements while I understand that the UK approach focuses on the host regulation.

Incoming branches are covered by Articles 39 et sequentes of MiFID II for retail clients, including professional clients by option, and by national regimes for professional clients by nature in the absence of a European equivalence. In the first case, however, MiFID II has not provided for the application of the DTO to branches of third country entities whereas they must apply the Share Trading Obligation. As regards the national regimes, they follow, to my knowledge, the same approach.

To some extent it could be considered that this approach is in contradiction with the provisions of MIFIR. Indeed, what justifies the DTO is "the direct, substantial and foreseeable effect within the Union" of the transactions. According to RTS 5, it is the case when a third country entity benefits from a guarantee provided by an investment firm established in the Union for more than an €8 bn notional amount or when two third country entities enter into a transaction through their branches in the Union.

Moreover, it is worth noting that both MIFID II and MIFIR state that third country firms should not be treated in a more favourable way than Union firms. Not applying the DTO to third country incoming branches while applying this obligation to EU investment firm could be viewed in many cases as granting the third country branches a more favourable treatment.

In the case of outgoing branches, the question is whether branches of EU firms operating outside the EU should apply the European DTO. It is my understanding that in the UK, the Derivatives Trading Obligation applies to all incoming branches, i.e. after Brexit, including UK branches of EU firms. Should UK branches of EU27 investment firms be subject to the European DTO? That would mean that in the event of a no deal Brexit, unless we come up with a suitable solution, these branches could de facto be faced with a conflict of law and

will probably have no other option than to trade in the US, where the platforms are considered equivalent.

At this point it is useful to recall that the purpose of setting up an entity outside the home jurisdiction is to better serve the clients in that third country.

Therefore, while it makes sense to apply parent company rules to third countries branches when the branch serves an EU client – notably to avoid circumvention of EU rules - I am not convinced that –in the case of derivatives trading obligations - there is a proper rationale to apply the parent company rules when the branch is servicing local clients.

In my view, it would seem much more logical to apply the Derivatives Trading Obligation to branches on a territorial basis, i.e. on the basis of the jurisdiction where they are established and not that of their parent company.

This approach is far from new: the European Commission adopted a similar approach in a Q&A precisely regarding the application of MIFID1 to branches. Some may argue that this Q&A is now somewhat dated, but GDPR used and adopted the same logic: it doesn't apply to third country branches as long as it concerns a non EU client.

The territorial approach has another advantage: it puts market players on an equal footing regardless of whether it is a branch or an entity. The territorial application ensures equal treatment between market participants - in this respect, it is worth restating a key principle of MIFID, which is that third country branches should not be granted more favorable treatment than local entities.

To sum up, as with many other pieces of legislation, the DTO presents challenges in a post Brexit context. I believe these can be overcome in a pragmatic and meaningful way by focusing the DTO on euro denominated instruments and applying it on a territorial basis to branches. Such an approach is "enforceable" by national regulators, is consistent with the policy intention and could put everyone on an equal footing.

In all cases, any way forward can only work if the UK authorities make clear their own interpretation and adopt an approach consistent with the EU 27 approach. Absent such clarification, we will not be able to avoid overlaps or worse arbitrage.

I do hope that such a pragmatic approach will prevail.

Thank you very much for your attention.

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