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Discours de Robert Ophèle, président de l'AMF - Conférence de l'ISDA (International Swaps and Derivatives Association) - "Perspectives pour la régulation européenne" - 2 décembre 2020 (en anglais uniquement)

Seul le prononcé fait foi

Good afternoon,

It is a pleasure to conclude this ISDA conference dedicated to European Public Policy, at a time when European market participants and regulators are both facing unprecedented challenges.

Today I will endeavour to compare how the UK and the EU have adapted their policy stance in the field of derivatives in order to cope with Brexit challenges. Since the UK has “onshored” MiFIR into its domestic law by way of the European Union Withdrawal Act 2018, it means that at the end of the transition period, a similar, if not the same, regulatory framework is still supposed to be implemented on both sides. One could therefore expect a well-balanced situation with a similar approach for specific issues, no conflicting requirements and a fair level playing field.

Unfortunately, when it comes to the Derivative Trading Obligation and the Derivative Clearing Obligation all will not be quite right; I will elaborate on these issues and conclude on how the forthcoming future of European regulation could be built up in a post-Brexit landscape.

A year ago, I delivered a speech at the ISDA annual conference where I focused on the derivative trading obligation, the DTO, in the perspective of the UK's withdrawal from the European Union. I tried to outline how this requirement could be safely implemented in case no equivalence was granted. One year later, equivalence is unlikely and, rather surprisingly, the way DTO will likely be implemented is the probably wrong way. Allow me to elaborate.

1 • As you all know the perimeter of the DTO is a subset of the DCO perimeter, the filter being a fuller degree of liquidity of the instruments to be covered by the DTO. This is of course challenging for the EU, in the case of Brexit without equivalence, since currently the bulk of liquidity on the instruments covered by the DTO is concentrated in the UK. However, since several platforms allowing execution of these instruments have settled in the EU ahead of the end of the transition period, one might conclude that some liquidity will rapidly relocate to the EU. It will probably be the case for Euro-denominated IRS; however, it will be most unlikely in the case of Sterling-IRS. And the case of US Dollar-denominated IRS is rather problematic. In addition, I understand that there will be no dedicated dealer-to-dealer platform for index CDS in the EU in January For these instruments, there is therefore a huge probability that European firms' ability to tap deep liquidity pools for derivatives pricing will be impaired, despite the relocation to the US of part of their trades and, consequently, also of their clearing.

2 • The second challenge involves the conflict of law between the UK and the EU DTO. Since the UK has "onshored" MiFIR in its domestic law, this means that, at the end of the transition period, a similar DTO will apply both in the UK and in the EU. The UK FCA has clarified that the 'UK DTO' applies to any third-country investment firm when it carries out MiFID business from an establishment in the UK, including a branch. At the same time ESMA has confirmed that branches of EU firms in the UK are covered by the EU DTO, thus meaning that these branches should trade on EU platforms, even when they trade with a UK counterpart.

These branches will therefore not be able to deal with UK counterparties that are primarily subject to the UK DTO, unless such transactions take place on third country platforms recognised as equivalent by both the European Union and the UK, such as US Swap Execution Facilities (SEFs).

Here we have a perfect example of an overlap of two sets of conflicting rules.

Based on French banks data, we could estimate that around 70 % of the volume of operations executed by branches of EU banks in the UK is at risk; it will either be lost or carried out on US SEFs.

Last year I called for 'overcoming these challenges in a pragmatic and meaningful way by focusing the DTO on euro-denominated instruments and applying it on a territorial basis to branches'.

Unfortunately to date, no such pragmatic solution has been adopted at European level.

As I mentioned, last week ESMA published its position on the matter. This states that the continued application of the DTO after the end of the transition period would not create risks to the stability of the financial system. This also states that although ESMA is aware of the challenges for UK branches of EU investment firms the situation is primarily a consequence of the way the UK has implemented the DTO and therefore proposes no pragmatic solution. ESMA will of course continue to monitor developments closely, but at this stage it does not recommend to review the scope of the DTO.

Allow me to offer a recap of some ideas/views I've heard over the past year on the DTO.

- Some said that it is the fault of the banks; after all, if European banks had only subsidiaries but no branches, there would be no issue. I believe that this is a wrong approach. As regards swaps and derivatives markets, from a risk management perspective, pursuing these activities through branches and managing a single book of derivatives at group level is the efficient way to manage the risks associated with these products.

- Others consider that keeping the scope of derivatives subject to the trading obligation unchanged would lend strength to CMU. My idea of CMU is indeed to build a mature market for EU counterparts trading on EU platforms but firstly on EU currency denominated products. The creation of a strong EU market in euro-denominated derivatives from scratch is to be supported where possible, but trying to build up a GBP and USD derivatives markets in Europe with no critical mass of strong market players in these fields would be detrimental to European market players, without bringing any added value to the European market. Forcing them to hedge their positions in markets which by definition are less liquid than the local markets of each currency would place them on an un-level playing field.

- You may have also read that these conflicting requirements were due to the way the UK is implementing the DTO; if they had endorsed the same approach as the EU, the issue would not have arisen. I do not share this view either since we do expect, in the EU, that branches of third-country banks trading with EU counterparts will use EU platforms. By not taking the same approach as the EU, the FCA has on the contrary avoided imposing overlapping conflicting requirements for the branches of UK banks in the EU.

- Finally, some have said that we should wait and monitor the market to gather appropriate data before starting to review the scope of derivatives subject to the DTO. Let me say that if we do so, it will be too late. The harm will have been done and - not to mention the time taken to react and reassess the criteria - the situation will be worse still.

In view of all of this, I do hope that the European DTO can still be rapidly adjusted both to the right scope of instruments and with a territorial approach. In the case of the latter, it is worth noting that there is already an article (article 33) in MIFIR which deals with potential cases of conflicting rules.

The regulatory stance has been much wiser and more prudent in the clearing perimeter in order to give clarity as soon as possible and to ensure the continuity of services provided.

Regarding clearing services and more generally all post-trade infrastructures, the European Commission's aim is pretty clear: the goal is to ensure that the European Union has significant market infrastructures for all the financial products issued by EU entities or those which are denominated in an EU currency. But also ensuring the implementation of this policy is appropriately phased in, in order to avoid triggering detrimental cliff effects.

Indeed, as you all know, in September the European Commission adopted an equivalence decision determining that the regulatory and supervisory framework applicable to CCPs established in the UK is equivalent to the European framework. Immediately thereafter, ESMA recognised the 3 UK CCPs as third-country CCPs allowed to provide services within the EU and has classified 2 of them as Tier 2 CCPs, since they are considered as systemically important for the financial stability of the EU. This Tier 2 classification will allow ESMA to exercise direct supervisory powers over such UK CCPs.

This is not the end of the story, since the European Commission expressly mentioned that the equivalence decision is time-limited to an 18-month period, which gives ESMA the opportunity to conduct a deep analysis of the systemic importance of the UK CCPs on the financial stability of the EU. In practice, this could lead to the conclusion that some Tier 2 CCP clearing services are of such substantial systemic importance that they should not be allowed to be massively located outside the EU if they intend to provide services to EU firms. In the meantime, the European Commission expects EU industry to develop a clear process to reduce their exposures and reliance on UK CCPs. In the coming months the clearing services landscape within the EU may therefore evolve drastically, since some clearing operations may be relocated within the EU or to the US.

It is now up to ESMA's Supervisory Committee, with the support of its three recently nominated, independent members, to conduct its analysis. Depending on the outcome,

ESMA may propose to the Commission that it does not to recognise some UK CCPs or some of the services provided.

Regarding OTC derivatives legacy transactions, a pragmatic approach has also been implemented.

Indeed, some OTC derivatives are currently exempt from bilateral margins and clearing requirements as they are legacy contracts. When re-papering the same contracts with an EU counterparty instead of a UK counterparty, there was a risk that such new novated derivatives replacing legacy ones, would fall within the scope of the bilateral margin requirement and the clearing obligation.

Therefore, the European Supervisory Authorities recently mentioned that they have developed draft regulatory solutions that should soon be endorsed by the European Commission. They expressly allow for the year 2021, UK counterparties to be replaced by EU ones, without triggering the clearing obligation and bilateral margin requirements.

Unfortunately, another Brexit-related issue regarding the derivatives has not been tackled by the European institutions and might lead to an un-level playing field which would be detrimental to EU firms.

Indeed, currently EU Pension Scheme Arrangements (PSAs) are exempt from the clearing obligation until June 2021, a deadline which could be further extended. Therefore, any OTC derivative traded between an EU PSA and another entity is exempt from the clearing obligation.

As an existing ESMA Q&A expressly mentions that third-country Pension funds do not fall within the scope of such exemption, as of 1st January 2021 UK Pension funds should no longer benefit from this exemption under EMIR, and notably when trading with EU banks.

The consequence of such a situation is that UK pension funds will cease OTC derivatives trading activities with EU counterparties because by doing so they would fall within the scope of the clearing obligation.

This issue could have been resolved by granting UK PSAs a grandfather clause until this temporary exemption lapses. Despite being well aware of the situation, neither ESMA nor the European Commission have taken action at this stage.

In parallel, the UK, on its side, has taken the initiative to exempt from the clearing obligation under its local regime, not only UK PSAs, as specified in the on-shored EU regulation, but also EU PSAs.

Needless to mention that this situation only favours UK firms which can still continue to enter into OTC derivatives contracts with both UK and EU PSAs without being subject to the clearing obligation; whereas EU firms will lose their UK PSA clients, in a context where the economy and stakeholders are already weakened.

The way these topical issues are being handled on the other side of the Channel is showing us how we should build up a strong and competitive European financial markets regulation in a post-Brexit environment.

The FCA has made it clear on several occasions that it will consider reviewing the on-shored regulation where appropriate.

Last year Andrey Bailey, then Chief Executive of the FCA, stated in a speech delivered at Bloomberg, that “the UK regulatory system would evolve somewhat differently.” He was of the view that the FCA will “take on board practical experience more rapidly” and that UK regulation “would be based more on principles”.

A few days ago Chancellor Sunak indicated that the UK approach was indeed straightforward, I quote, “we will use equivalence when it is in the UK’s economic interests to do so”.

This definitely illustrates just how the UK will shape future financial market regulation domestically. It will become even more flexible with an ability to be agile and will have the strengthening of UK competitiveness at heart as provided by the FCA statutory objective.

In this competitive context, we also need to build up a strong European market and to react quickly to how financial markets evolve. In the near future, the review of the MiFID regime – in addition to the recovery package – will be the opportunity to strengthen our financial markets.

I am of the view that there are areas where the framework should be simplified in order to make the rules fit for a stronger common EU27 market.

The transparency regime of MiFID 2 is an example of where simplification is needed. I often refer to the tremendous amount of waivers to the pre-trade transparency obligation to

illustrate where streamlining is necessary. In total, for the equity and non-equity markets, around 900 waivers have been submitted to ESMA under MIFID2.This definitely questions the relevance of the transparency rules.

Besides simplification there is also a need for harmonisation. To focus specifically on the non-equity post-trade regime, the fact that the deferral of publication is very much left to the discretion of National Competent Authorities is clearly suboptimal and leads us to face highly disparate practices across Europe. This should be better calibrated and harmonised across the Union, also taking the competitive aspects of such changes into consideration. This is the difficult but challenging equilibrium the European legislators will have to establish.

Thank you for your attention.

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