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Speech by Robert Ophèle, AMF Chairman - ISDA virtual Derivatives Trading Forum – 29 June 2021

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Good afternoon or good morning depending on where you are.

It is a great pleasure for me to speak at this ISDA virtual Derivatives Trading Forum which once again has drawn such a wide variety of market participants.

If one thinks that strong derivatives markets are instrumental for an efficient financial intermediation, and I do believe it is the case, financial regulators should then be dedicated to encouraging their development, building on competitive market players and balancing adequately the stakeholders' concerns regarding competitiveness with financial stability and sovereignty considerations.

In this context, I would like to illustrate today this stance by focusing on four main topics. This number, four, illustrates how busy our agenda is! I will therefore be brief on each of them.

Quite unusually, I will start with a few words on a very specific segment of the derivatives field, commodity derivatives, where the EU has demonstrated its capacity to be sharp and pragmatic.

I will then switch to the Derivatives Trading Obligation, the so-called "DTO", which plays a fundamental role in the derivatives landscape and which is instrumental in the building of such robust markets.

My third point will address the topic of the ending of historical IBOR benchmarks and their replacement by new Risk-Free-Rate benchmarks, which will lead to some changes in the regulation of derivatives markets in particular with regard to the scope of the Clearing and Derivatives Trading Obligations.

I will finally say a few words about the Open Access principle and the regulatory challenges that the EU is facing.

Commodity derivative markets have always been politically sensitive markets since they are directly connected with the so-called real economy, whether contracts are physically settled or not. The EU Capital Markets Recovery Package was a good opportunity to fine tune the European regulatory landscape which was obviously not totally fit for the purpose, hampering for instance the take-off of new contracts. In order to facilitate the orderly development of these markets, especially the development of green EU energy markets including emission allowances, both the position limit and the transparency framework have been widely reviewed and updated.

The Recovery Package has indeed introduced significant changes to the MiFID II commodity derivatives framework. Most notably, the scope of commodity derivatives subject to position limits has been significantly reduced, as position limits will continue to apply only to agricultural commodity derivatives and to the most significant contracts. Exemption from position limits for positions resulting from mandatory liquidity provision on a trading venue or for hedging positions held by a financial entity that is part of a predominantly commercial group have also been introduced.

While the new provisions are only expected to start applying in February 2022 after transposition into national law by Member States, you know the cumbersome EU legislative process when it comes to directives, ESMA has decided "to not prioritize" the enforcement of the still applicable regulation, pending application of the new framework relating to the two first points. It demonstrates that ESMA can be pragmatic in some circumstances. "To not prioritize" is actually the European euphemism for a full-fledged "no action letter".

In the meantime, Level 2 regulation is in the process of being amended. Consultation has already started on four draft RTSs while the consultation on amendments to RTS2, which specifies the pre- and post- trade transparency thresholds for Large-In-Scale and SSTI (Size

Specific To the financial Instrument) waivers, is expected to be launched early July. I strongly invite you all to comment on these drafts.

It is nevertheless fair to say that it should not be the end of the story. A review of the appropriateness of the clearing thresholds, which are set at relatively low levels in Level 2 regulation, and more fundamentally the review of the way they are defined in EMIR appears highly opportune taking into account the lack of equivalence of many key third country trading platforms under EMIR 2a. Such a review would draw on a comparison with the different approaches implemented in other major jurisdictions.

While focusing on how to build strong derivatives markets in the EU, one cannot avoid discussing how the Derivatives Trading Obligation operates and its potential impacts.

The consequences of the EU approach to the Derivatives Trading Obligation in the context of Brexit were not a surprise.

The DTO rule requires certain classes of derivatives (namely Euro, Sterling and US Dollar IRS as well as some Index CDS) to be traded on EU platforms or third-country platforms that are recognised as equivalent. Since Brexit, UK platforms are no longer eligible to meet that obligation, despite the UK derivatives markets being the main pool of liquidity prior to Brexit.

Furthermore, since the UK has “onshored” MiFIR into its domestic law, a similar DTO applies to counterparties in the UK, including branches of EU firms in the UK. These branches must simultaneously comply with both the EU and the UK DTO. Such overlap prevents them from dealing with UK counterparties, unless transactions are concluded on third-country platforms recognised as equivalent by both the European Union and the UK, such as US Swap Execution Facilities (SEFs).

Brexit has reshaped the derivatives market landscape. Euro-denominated IRS are now increasingly being traded in the EU: from around 6% in mid-2020, the market share of EU platforms increased to almost 40% in Q1 2021. Sterling and US Dollar IRS are mainly traded on US SEFs. For Sterling swaps, SEFs represented 16% of market share in mid-2020 and reached 40% in Q1 2021. As for US Dollar swaps, SEF market share has remained stable at around 60%. As regards iTraxx CDS dealer-to-dealer markets, a clear shift from UK towards US platforms has been observed since January.

So, if we focus on euro-denominated swaps, the DTO has been instrumental in strengthening the market in the EU, which is exactly its purpose.

The development of such a strong market should stand at the forefront of our concerns for all euro-denominated products. This being said, we still need to tackle two issues:

- First, as I have highlighted several times earlier, the implementation of the DTO is partly incoherent and inconsistent. It is regrettable that EU counterparties can no longer deal with UK counterparties, even in Sterling or Dollar, outside of US SEFs because of the overlap between the UK and EU DTO. This mainly penalises branches of EU firms which happen to be amongst the most active players in these markets. If we want to allow EU companies to be competitive beyond our borders, we need to rethink how the EU DTO should apply to the non-EU business of these branches.

- Second, currently, there is a lack of a real dealer-to-dealer iTraxx CDS market in the EU. In my view, the fact that the EU does not host a single active market for CDS on European indices is an issue of sovereignty. It is not satisfactory that CDS on European indices should be traded mainly outside the EU. Everything should be done to encourage the creation of such a market within the EU. This responsibility lies with all market participants, not just with regulators.

To date, we have failed to tackle these issues and I do hope they will be high on the forthcoming MiFIR Review agenda.

One of the next challenges the derivatives market is about to face is the ending of major interest reference rates which are widely used as benchmarks for a broad range of derivative contracts and the necessary transition to Risk-Free-Rate Benchmarks under the EU Benchmark Regulation.

As you know very well, by year-end, most of the LIBOR benchmarks will cease to be published except for some US Dollar LIBOR tenors, which will continue to be published until June 2023 (excluding the 1 week and 2 month USD settings). There is a clear risk to financial stability, should reliance on LIBOR continue to the current extent. The ISDA-Clarus RFR Adoption Indicator in May stands at 10.7% and, in terms of notional amount traded, only 11.8 % of the notional amount traded concerned RFRs linked to interest rate derivatives. Market participants should urgently stop referencing LIBOR benchmarks in their contracts, and use alternative reference rates without delay.

In addition, both the EU Clearing obligation and Derivatives Trading Obligation encompass derivatives referencing benchmarks that are about to cease – such as the LIBOR and EONIA (the latter being replaced by €STER) - and it is therefore the right timing to update the list of in-scope derivatives to adapt to the transition.

ESMA is expected to consult on potential changes to the scope of the clearing and trading obligations in the coming weeks in order to have an updated regulatory framework on time, meaning before the end of the year. Incidentally, I note that the Bank of England has also consulted on its approach regarding the scope of the UK clearing obligation following the emergence of new Risk-Free-Rate benchmarks.

What should be dropped and what should be introduced and what should be the appropriate timing?

Regarding the scope of the EU clearing obligation, we need to carefully assess to what extent new benchmarks are sufficiently liquid, and whether CCPs are already offering clearing services for the classes of derivatives referencing them.

The scope of the EU derivatives trading obligation only covers a subset of the derivatives within the scope of the clearing obligation. A similarly careful analysis should be carried out in light of where we stand today and where we could be early next year.

All developments within these markets must be considered, and we would very much welcome any input from market participants. I hence encourage you all to respond to ESMA’s consultation.

The fourth challenge that the EU is currently facing regarding the regulation of derivatives markets is the open access regime under the MiFIR regulation. Here my remarks will only focus on open access regarding exchange-traded derivatives (ETDs).

Simply put, the open access regime is about giving trading venues the right to access a clearing house's clearing services. Reciprocally, clearing houses that wish to clear exchange-traded derivatives (ETDs) traded on a given trading venue, can request access to its trade feeds.

The main rationale behind this regime was to develop a more efficient EU market by increasing competition among market infrastructures, allowing investors to choose freely where they want to clear a derivative transaction.

The MiFIR open access provisions were originally designed for situations where either the clearing house or the exchange would not voluntarily grant access to the other. Access should be granted provided that such access does not affect the smooth and orderly functioning of the markets or adversely affect systemic risk.

The open access provisions contain a multi-party procedure whereby an access request must be sent to 3 entities:

- (i) the market infrastructure to which access is sought,
- (ii) the competent authority of this market infrastructure and
- (iii) the competent authority of the market infrastructure requesting access.

This is a complex procedure that involves two regulators. Each one of them could potentially have a different opinion on how to apply the notion of smooth and orderly functioning of the markets, thus rendering the open access regime inapplicable.

As a consequence, we have always voiced our concern that the open access regime can only be effective if access requests are reviewed and processed by a single regulator, namely the ESMA.

Pending such reforms and noting that the UK has recently decided to permanently remove the open access regime for ETDs, I firmly support the postponement of the open access provision for a significant amount of time in order to re-assess its usefulness and its possible operational implementation.

Allow me to conclude on a more positive note by pointing out a domain where the EU is well under way to promote strong as well as agile markets, whilst keeping the EU competitive, namely the proposal for an EU DLT Pilot Regime.

We strongly support the proposal introducing a pilot regime to test under a proportionate and clear regulatory regime, the setting up and operation of market infrastructures based on DLT for the trading and settlement of transactions on security tokens. The legislative process is progressing smoothly and I do hope that it will be finalized shortly.

This Pilot Regime is therefore welcome. It could encourage the emergence of innovative projects in the EU and could avoid the EU being a laggard in this line of innovation. I do believe that a pilot regime could be relevant for many instruments and, at some point, for derivatives. I do hope that many of you will take full advantage of this regime that will pave the way for a thoroughly tested fully fledged regulatory framework.

Thank you for your attention.

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