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**REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND  
THE COUNCIL**

**on the need to temporary exclude exchange-traded derivatives from the scope of Articles  
35 and 36 of the Regulation (EU) No 600/2014 on markets in financial instruments**

# REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

## on the need to temporarily exclude exchange-traded derivatives from the scope of Articles 35 and 36 of the Regulation (EU) No 600/2014 on markets in financial instruments

### 1. INTRODUCTION

This report to the European Parliament and to the Council ('**Report**') provides an assessment of the need to temporarily exclude exchange-traded derivatives ('**ETDs**') from the scope of Articles 35 and 36 of the Regulation (EU) No 600/2014 on markets in financial instruments ('**MiFIR**'). Under Article 52(12), the European Commission is required to report to the European Parliament and to the Council on the need to temporarily exclude ETDs from the non-discriminatory access provisions to central counterparties (hereinafter: "**CCP**") and trading venues under Articles 35 and 36 of MiFIR for up to thirty months following 3 January 2018.

Article 52(12) of MiFIR provides that the European Commission should base its Report on a risk assessment carried out by ESMA in consultation with the ESRB and shall take into account the risks resulting from open and non-discriminatory access provisions regarding ETDs to the overall stability and orderly functioning of the financial markets throughout the Union. On July 2015, the Commission asked ESMA in collaboration with ESRB to carry out such a risk assessment. ESMA delivered its risk assessment<sup>1</sup> on 31 March 2016 based on an ESRB opinion published on 9 February 2016<sup>2</sup>.

In carrying out its risk assessment, ESMA was asked by the Commission to: (i) identify potential risks factors and assess their likelihood, as well as the magnitude of the damaging effects on financial systems; (ii) assess the existence of systemic risk on the basis of risk factors which can be deemed specific to access arrangements pursuant to MiFIR, and (iii) include detailed qualitative and quantitative analysis supporting its arguments.

The Commission takes note that given the absence of data on operating access arrangements for ETDs under MiFIR, ESMA was unable to conduct a quantitative assessment as requested by the Commission.

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<sup>1</sup> ESMA, *Risk Assessment on the temporary exclusion of exchange-traded derivatives from Articles 35 and 36 MiFIR*, 4 April 2016, [https://www.esma.europa.eu/sites/default/files/library/2016-461\\_etd\\_final\\_report.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-461_etd_final_report.pdf)

<sup>2</sup> ESRB response to ESMA on the temporary exclusion of exchange-traded derivatives from Articles 35 and 36 of MiFIR, 9 February 2016, [https://www.esrb.europa.eu/pub/pdf/other/160210\\_ESRB\\_response.pdf?b34727f97ef6c1ef3a9fd58f3d67035e](https://www.esrb.europa.eu/pub/pdf/other/160210_ESRB_response.pdf?b34727f97ef6c1ef3a9fd58f3d67035e)

## 2. SCOPE OF THE REPORT

As in Regulation (EU) No 648/2012 (EMIR) for OTC derivatives, MiFIR establishes a clearing obligation for ETDs<sup>3</sup> as well as a non-discriminatory and transparent access to CCPs and trading venues for transferable securities, money market instruments, and ETDs.

EMIR defines OTC derivative as a derivative contract not concluded on a regulated market or a third country market considered as equivalent to a regulated market<sup>4</sup>. In contrast, MiFIR defines ETDs<sup>5</sup> as "*a derivative that is traded on a regulated market or on a third-country market considered to be equivalent to a regulated market*" and as such does not fall into the definition of an OTC derivative as defined in EMIR.

Thus, where MiFIR open and non-discriminatory access provisions apply to derivatives traded at least on a regulated market, the EMIR open access provisions apply to derivatives only traded OTC, including derivatives traded on multilateral trading facilities or organised trading facilities provided that they are not otherwise traded on a regulated market or third-country market considered to be equivalent to a regulated market.

According to Article 52(12) of MiFIR, this report only covers ETDs and thus does not include transferable securities, money market instruments and OTC derivatives.

## 3. NON-DISCRIMINATORY ACCESS PROVISIONS IN MiFIR

Open and non-discriminatory access provisions are aimed at strengthening competition between trading venues and CCPs, and ultimately reducing costs for end investors, by preventing discriminatory practices that may exist, both at the CCPs' and trading venues' levels.

Article 35 of MiFIR specifies that a CCP shall grant access to trading venues on a non-discriminatory and transparent basis to clear transactions regardless of the trading venue on which they are executed. In this context, open and non-discriminatory access is aimed at ensuring that a trading venue has the right to non-discriminatory treatment in terms of how contracts traded on its platform are treated in terms of (i) collateral requirements and netting of economically equivalent contracts and (ii) cross-margining with correlated contracts cleared by the same CCP. This should give trading venues the possibility to decide which CCP(s) may clear transaction executed on their platforms.

In parallel, Article 36 of MiFIR specifies that a trading venue shall, upon request, grant access to its trade feeds to CCPs that wish to clear transactions on this trading venue on a non-discriminatory and transparent basis.

MiFIR anticipated however that under certain circumstances open access to CCPs and trading venues may raise risks and have potential drawbacks that could outweigh the policy objectives of enhanced competition. In that context, Articles 35 and 36 of MiFIR establish the

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<sup>3</sup> Article 29(1) of MiFIR.

<sup>4</sup> Article 2(7) of EMIR.

<sup>5</sup> Article 2(32) of MiFIR.

conditions under which access may be denied. The competent authorities of the CCP and the trading venue may thus deny access to a particular CCP or trading venue where granting access would (i) threaten the smooth and orderly functioning of the market, in particular due to liquidity fragmentation, or would adversely affect systemic risk, or (ii) require an interoperability arrangement (for ETD), except where the trading venue and the CCPs involved have consented to this arrangement and if the risks arising from this arrangement are collateralised at a third party<sup>6</sup>. Furthermore, access may also be denied by CCPs and trading venues where it creates significant undue risk that cannot be managed based on the anticipated volume of transactions, operational risk and complexity as well as other factors creating significant undue risks<sup>7</sup>.

These conditions are detailed in the regulatory technical standard on clearing access in respect of trading venues and central counterparties<sup>8</sup>, which also covers the conditions under which access shall be granted, the notification procedures and other requirements<sup>9</sup>. In particular, the technical standard further specifies the different type of risks, either based on the anticipated volume of transactions, on the operational risk and complexity as well as other factors creating significant undue risks (e.g. new product, threaten to the economic viability of the CCP or the trading venue, legal risk, or incompatibility between trading and clearing rules).

In addition, MiFIR introduces specific provisions to adequately take into consideration the complexity of ETDs and the consequent challenges that open and non-discriminatory access may entail. In particular, ETDs, are complex due to their long maturities and leverage effects.

In the case of ETDs, the trading venue or the CCP shall provide a written response within six months, instead of three months for other financial instruments, and make access possible within three months of providing a positive response to the access request. Where a competent authority, the trading venue or the CCP refuses to grant access, it shall provide full reasons of its decision and inform the relevant competent authorities.

MiFIR also provides for a transitional arrangement for trading venues offering trading in ETDs with annual notional amount traded below EUR 1 000 000 million<sup>10</sup>, which may opt out from the open and non-discriminatory access provisions for a period of thirty months (and up to sixty months under certain conditions<sup>11</sup>) from the date of application of MiFIR.

Finally, according to Article 52(12) of MiFIR and subject to the conclusions of this Report, the Commission may decide to exclude ETDs from the scope of Articles 35 and 36 of MiFIR for a maximum period of 30 months on the basis of a risk assessment carried out by ESMA in consultation with the ESRB. Article 54(2) of MiFIR further provides that in the case that the

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<sup>6</sup> Articles 35(1), 35(4) and 36(4) of MiFIR.

<sup>7</sup> Articles 35(6)(a) and 36(6)(a) of MiFIR.

<sup>8</sup> Commission delegated regulation of 24 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on clearing access in respect of trading venues and central counterparties.

<sup>9</sup> See ESMA's mandate to develop draft regulatory technical standards under Articles 35(6) and 36(6).

<sup>10</sup> Article 36(5) of MiFIR.

<sup>11</sup> According to Article 36(5) MiFIR, a trading venue that remains below the EUR 1 000 000 million threshold of annual notional amount traded in ETDs during the first thirty months of the opt out period, can benefit from an additional thirty months opt out period.

Commission decides not to temporarily exclude ETDs from the scope of Articles 35 and 36 of MiFIR, a CCP or a trading venue may apply to its competent authority for permission to avail itself of transitional arrangements. The competent authority, may assess the risks resulting from the application of the open and non-discriminatory access as regards ETDs to the orderly functioning of the relevant CCP or trading venue, and may decide that the relevant CCP or trading venue be exempted from the access obligations for a transitional period until 3 July 2020.

#### **4. ETD's MARKET STRUCTURE**

It should be noted that ESMA's risk assessment was published in April 2016, at the very early stage or in advance of the implementation of new regulatory requirements that aim at ensuring that (i) trading in liquid and standardised derivatives is carried out as far as possible on trading venues and that (ii) both relevant OTC derivatives and ETDs are cleared centrally in order to reduce systemic risk.

Together with ESRB, ESMA considers that the introduction of the obligation to trade on a trading venue under Article 28 MiFIR for OTC derivatives that fulfil certain conditions is expected to increase the number of derivatives traded on traded venues<sup>12</sup>, including on regulated markets. Derivatives brought onto regulated markets will therefore be considered as ETDs and thus be subject to the obligation to clear ETDs by a CCP in accordance with Article 29 MiFIR.

According to ESMA's findings, the European derivatives market is mainly OTC. As of end-June 2016, the global size of ETDs market was slightly above 10% of the global derivatives market which itself follows a declining trend since 2008<sup>13</sup>. In terms of notional amount outstanding, ETDs market is mainly composed of interest rate derivatives (IRD) split into 60% of options and 40% of futures.

ESMA's risk assessment also highlights a consistency in the significant drop in the percentage of daily cleared outstanding notional for ETDs in recent years, with the progressive switch to longer-maturity instruments.

ESMA further describes European ETDs market as highly concentrated both at trading and clearing level, combined with a vertically integrated market infrastructure where dominant trading and clearing structures are part of the same integrated groups. In 2014, the biggest CCP in terms of number of ETDs trades cleared held a 58% market share while the three biggest held together 90% of the market. A number of smaller players share the remaining market shares.

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<sup>12</sup> The trading obligation in Article 28 MiFIR is considered fulfilled if the transaction is conclude on a regulated market, but also on Multilateral Trading Facilities and Organised Trading Facilities.

<sup>13</sup> See Bank for International Settlements, Triennial Central Bank Survey - OTC derivatives positions at end-June 2016, Table 1, Monetary and Economic Department, 11 December 2016, [http://www.bis.org/publ/otc\\_hy1612/triensurvstatannex.pdf](http://www.bis.org/publ/otc_hy1612/triensurvstatannex.pdf)

When assessing the market structure on an asset class basis, ESMA concludes that the market is even more concentrated with one exchange holding over 70% of equity ETDs in terms of value traded and another holding about 80% of bond ETDs still in terms of value traded.

The case of commodity ETDs is slightly different – with the exception of energy ETDs – as the commodity ETDs market is characterised by a high level of specialisation and little overlap among trading venues and CCPs.

In parallel, in the OTC market, the ongoing implementation of EMIR clearing obligation has already and will continue to bring a significant share of the derivatives contracts traded OTC to central clearing. Following ESMA's regulatory technical standards under EMIR, the European Commission has indeed already adopted delegated acts for the central clearing of IRS (denominated in UR, GBP, JPY, USD, NOK, PLN and SEK) and Index Credit Default Swaps (CDS) denominated in EUR<sup>14</sup>, bringing about 70% of the OTC derivatives market in these classes into clearing<sup>15</sup>. It should also be noted that although the clearing offer is very concentrated, six different CCPs offer clearing services for IRS.

The Commission takes note that (i) interest rates derivatives represent the main share of the ETDs market; (ii) MiFIR trading obligation might bring into the ETDs definition a part of the interest rate derivatives; (iii) EMIR clearing obligation is already applicable to IRS and (iv) despite the market concentration the interest rate derivative market is split between six different CCPs. The Commission therefore agrees with ESMA's conclusions that interest rate derivative is the most relevant asset class when assessing the consequences of the implementation of the open and non-discriminatory access provisions for ETDs.

## **5. RISK ASSESSMENT OF OPEN AND NON-DISCRIMINATORY ACCESS PROVISIONS FOR ETDs**

Although the open access provisions under MiFIR are not implemented yet, ESMA reports that some EEA CCPs and trading venues have already developed and successfully make use of access arrangements for either ETDs or OTC derivatives<sup>16</sup>. ESMA considers that the access arrangements applied by market infrastructures under EMIR provisions<sup>17</sup> have not raised any noticeable systemic risk so far. This is despite the fact that OTC derivatives are generally less standardised and more complex than ETDs.

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<sup>14</sup> Commission delegated regulation (EU) 2015/2205 of 6 August 2015 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation ; Commission delegated regulation (EU) 2016/592 of 1 March 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation ; Commission delegated regulation (EU) 2016/1178 of 10 June 2016 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on the clearing obligation.

<sup>15</sup> Progressive implementation started in 21 June 2016; see ESMA's *Risk Assessment on the temporary exclusion of exchange-traded derivatives from Articles 35 and 36 MiFIR*, 4 April 2016, figure 11, p. 10.

<sup>16</sup> See ESMA's *Risk Assessment on the temporary exclusion of exchange-traded derivatives from Articles 35 and 36 MiFIR*, 4 April 2016, Table 2, p. 16.

<sup>17</sup> Articles 7 and 8 of EMIR.

However, in line with ESMA's assessment, the European Commission is of the view that the existing access arrangements for ETDs may still in principle generate risks that could threaten the smooth and orderly functioning of markets or adversely affect systemic risk.

In that perspective, and taking into account ESRB's macroprudential risk assessment, ESMA underlines a series of potential risks that might arise from the implementation of open and non-discriminatory access provisions to ETDs under MiFIR.

### **5.1 Risk from open and non-discriminatory access at CCP level**

Open and non-discriminatory access to CCPs will ensure that trading venues will be able to have their trades cleared in the CCP of their choice. This is particularly relevant against the background of the expected implementation of the trading obligation that will bring many OTC derivatives into the scope of the MiFIR open and non-discriminatory access provisions and might be accompanied with the entry of new trading venues with no access to vertically integrated CCPs. As outlined by ESMA in its risk assessment, trading and clearing costs are closely interlinked. The cost of trading on a trading venue is assessed by market participants together with the associated clearing costs. A trading venue cannot be competitive if it cannot give access to attractive clearing costs. Without these provisions, new and non-vertically integrated trading venues would be prevented from entering the market and thus unable to promote a more competitive and a less concentrated market.

#### ***Concentration Risk***

Taking these objectives into account, the Commission shares ESMA's views that one of the main risks associated with open and non-discriminatory access provisions for ETDs is a new concentration risk ("single point of failure"). Under this risk scenario, the possibility for trading venues to choose their CCP, could lead to a situation where the most attractive CCP for one specific ETDs or asset class, becomes the single place for central clearing. This situation could also arise where, in order to maximise netting efficiency and reduce collateral requirements, market participants opt for one single (the biggest) CCP.

However, given competition and market structure and dynamics, this scenario is unlikely to occur. Notably, ESMA reports that such significant shift of clearing to a single CCP would be deterred by the risk that the CCP would likely increase clearing fees for all its clearing members to a point that it would no longer be attractive to counterparties. In addition, a high level of concentration would expose the financial system to a single point of failure with potential systemic consequences and the impossibility for market participants to efficiently move their positions to another CCP in case of failure.

The Commission also concurs with ESRB's and ESMA's findings that the clearing market is already highly concentrated in the EU, with some ETDs or asset classes being exclusively or predominantly cleared in one CCP. It can even be expected that, independently from the implementation of the open and non-discriminatory access provisions, the concentration could

be reinforced in the future as a result of "*the 'natural' commercial growth of a CCP's business when its services successfully meet the preferences of market participants*"<sup>18</sup>.

On the contrary, it could be argued that the existing concentration can be explained by existing entry barriers which the open and non-discriminatory access rules are meant to diminish. In fact, where CCPs can request access to trading venue under open and non-discriminatory access provision in MiFIR, this reduces barriers to entry for new CCPs.

The Commission notes that EMIR and MiFIR provide for safeguards to deal with this concentration risk. First, CCPs are regulated by the relevant competent authorities under EMIR which establishes organisational conduct of business, prudential standards and macroprudential rules for CCPs. Second, MiFIR gives powers to competent authorities to deny access to CCP should it threaten the smooth and orderly functioning of markets or adversely affect systemic risk or require an interoperability arrangement.

### ***Operational risk***

Another important set of risks is that of undue risk that the CCP cannot managed based on the anticipated volume of transactions of the trading venue, operational risk and complexity as well as other factors creating significant undue risks<sup>19</sup>. ESMA considers that these risks could potentially increase systemic risk by impacting clearing members of other CCPs.

In this regard, in parallel to EMIR Title IV requirements on organisation, conduct of business and prudential requirements, MiFIR allows CCPs to deny access if after making all reasonable efforts to manage its risks, the CCP concludes that there are significant undue risks that cannot be managed<sup>20</sup>.

Taking into account the above considerations, the Commission considers that the open and non-discriminatory access provisions to CCP for ETDs under MiFIR is likely to have overall positive impact on the market. And where potential risks arising from such provisions cannot be ignored, the Commission considers that MiFIR and EMIR already establish strong safeguards to mitigate undue operational risks to CCPs or increased systemic risk.

## **5.2 Risk from open and non-discriminatory access at trading venue level**

Open and non-discriminatory access to trading venues enables CCPs to clear trades concluded on the trading venues of their choice. Beyond the promotion of a more competitive environment, this provision aims at giving to the trading members of a trading venue, the possibility to choose the CCP in which they want to clear their trades, including when the CCP and the trading venue are vertically integrated in the same group.

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<sup>18</sup> ESRB response to ESMA on the temporary exclusion of exchange-traded derivatives from Articles 35 and 36 of MiFIR, 9 February 2016; p.4.

<sup>19</sup> Articles 35(6)(a) of MiFIR.

<sup>20</sup> Section 1, Articles 1 to 4, Commission delegated regulation of 24 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on clearing access in respect of trading venues and central counterparties.

This can be particularly beneficial for market participants that wish to maximise netting efficiency and reduce collateral requirements across their positions on different trading venues.

In addition, from a financial stability perspective, the Commission shares ESMA's and ESRB's views that a multiple CCP environment contributes to reducing systemic risk by strengthening their substitutability in case of failure. If one CCP connected to a trading venue is in distress, the other CCPs connected to that trading venue would be able to continue clearing its trades.

### ***Risks in relation to interoperability arrangements***

Article 2 of EMIR defines an interoperability arrangement as an arrangement between two or more CCPS that involves a cross-system execution of transaction. Such arrangements aim at to ensure that two or more CCPs can face exposures to each other as a result of the process whereby they net the trades of their participants across the linked CCPs.

In the absence of an interoperability arrangement, members holding positions on different CCPs would suffer netting inefficiencies, higher collateral needs and liquidity fragmentation. That would reduce the market participant interest in a multiple CCP environment. From a systemic risk perspective, ESMA reports underlines that such a scenario would furthermore adversely reinforce procyclicality.

While most of the risks described above would disappear if the different CCPs connected to a trading venue were using interoperability arrangements, the Commission takes note of the ESRB's major concern on the risk associated with the potential multiplication of such interoperability arrangements with the implementation of open and non-discriminatory access to ETDs. Indeed, interoperability arrangements under EMIR are only applicable to transferable securities and money market instruments. ESMA and ESRB further caution that their use in the context of ETDs might introduce a substantial degree of complexity and risk inherent to the characteristics of derivatives and might have adversely consequences on the overall operation risk management at CCP level.

The Commission; however, considers that MiFIR introduces safeguards to ensure that these risks are appropriately mitigated. First, according to Article 36(4)(a), the competent authorities shall deny access to the CCP where the access would require such interoperability arrangement. An interoperability arrangement could thus only be established between the different CCPs of the trading and the trading venue, have consented to it. Second, should the interoperability arrangement threaten the smooth and orderly functioning of the market, the competent authorities shall still deny access to the trading venue.

### ***Operational risk***

Operational risks arising from the complexity of anticipated volume of transactions, as well as other factors creating significant undue risks, are also envisaged in MiFIR.

In such a case, under Articles 36(6) of MiFIR and according to the provisions detailed in the regulatory technical standards on clearing access in respect of trading venues and central counterparties<sup>21</sup>, the trading venue may deny access.

## **6. CONCLUSIONS**

The Commission notes that EMIR open and non-discriminatory access provisions already apply to OTC derivatives, transferable securities and money market instruments without temporary exemptions. Following ESMA's assessment, it appears that these access arrangements have not caused any noticeable systemic risk. It is noteworthy in this regard that OTC derivatives are generally less standardised and more complex than ETDs. In consequence, it can be expected that the implementation of MiFIR open and non-discriminatory access provisions to ETDs may not raise more complexity than for OTC derivatives.

The implementation of open and non-discriminatory access to ETDs under MiFIR might nevertheless raise risks that could potentially threaten the smooth and orderly functioning of markets or adversely affect systemic risk. More specifically, this report outlines a number of potential risks and in particular risks in relation to (i) the concentration of the trading and the clearing activity in vertically integrated groups, and to (ii) the potential multiplication of interoperability arrangements that would substantially raise the level of complexity in the overall risk management of interoperable CCPs.

Having examined these risks, the Commission considers that the current regulatory framework in MiFIR and EMIR appropriately addresses the potential risks identified. In addition to their regulation by relevant competent authorities, EMIR establishes organisational conduct of business, prudential standards and macroprudential rules for CCPs. In parallel MiFIR gives the possibility for CCPs, trading venues and relevant authorities to deny access to the relevant infrastructure, as detailed in the regulatory technical standard on clearing access in respect of trading venues and central counterparties, should the CCP, the trading venue or the market be potentially put at risk.

On this basis, the Commission concludes that it is not necessary to temporarily exclude exchange-traded derivatives from the scope of Articles 35 and 36 of MiFIR.

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<sup>21</sup> Section 2, Articles 5 to 8, Commission delegated regulation of 24 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council with regard to regulatory technical standards on clearing access in respect of trading venues and central counterparties.