

European Securities and Markets Authority
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ESMA's Consultation Paper on the Clearing Obligation under EMIR (no. 3)

Dear Sirs,

We welcome the publication of ESMA's Consultation Paper on the *Clearing Obligation under EMIR (no.3)* (the "**Consultation Paper**" or "**CP**") and we appreciate the opportunity to provide you with our comments.

Markit is a provider of financial information services to the global financial markets, offering independent data, valuations, processing and connectivity services, risk analytics for internal capital models, and related services across regions, asset classes and financial instruments. Our products and services are used by numerous market participants to reduce risk, increase transparency, and improve the operational efficiency in their financial markets activities.¹

Markit has been actively and constructively engaged in the debate about regulatory reform in financial markets, including topics such as the implementation of the G20 commitments for OTC derivatives and the design of a regulatory regime for benchmarks. Over the past years, we have submitted more than 115 comment letters to regulatory authorities around the world and have participated in numerous roundtables. We also regularly provide relevant authorities with our insights on current market practice, for example, in relation to valuation methodologies, the provision of scenario analysis, or the use of reliable and secure means to provide daily mid-market marks. We have also advised regulatory authorities on appropriate approaches to enabling a timely and cost-effective implementation of newly established regulatory requirements, for example through the use of multi-layered phase-in or by providing market participants with a choice of means for satisfying regulatory requirements.

Introduction

Markit's most relevant services in the context of ESMA's CP are our derivatives processing platforms which facilitate confirmation, matching and processing for OTC derivatives across regions and asset classes and provide universal middleware connectivity for downstream processing such as clearing and reporting. Specifically, the MarkitSERV² platforms a) facilitate the agreement³ between parties on the details of the

¹ Please see www.markit.com for further information.

² MarkitSERV, a wholly owned subsidiary of Markit Group Limited, provides a single gateway for OTC derivatives trade processing. The company offers trade processing, confirmation, matching, and reconciliation services across regions and asset classes, including interest rate, credit, equity, and foreign exchange derivatives. MarkitSERV also connects dealers and buy-side institutions to trade execution venues, CCPs, and trade repositories. Please see www.markitserv.com for additional information.

³ Depending on the asset class and type of execution, different methods will be used to achieve such "agreement", including affirmation/confirmation or matching.

transactions that they have entered into, b) provide them with connectivity to CCPs,⁴ trading venues (“TVs”) and inter-dealer brokers, trade repositories, and the whole range of counterparties, including buy-side and sell-side, and c) report the relevant transaction and counterparty details to trade repositories under newly established regulatory requirements.⁵ Such services that are also offered by various other providers are widely used by participants in the global OTC derivatives markets today and are recognised as tools to increase efficiency, secure legal certainty, and reduce cost. With globally over 1,500 firms using the various MarkitSERV platforms that process, on average, 80,000 OTC derivative transaction processing events per day, our legal, operational, and technological infrastructure plays an important role in supporting the OTC derivatives markets in Europe, North America, and the Asia-Pacific region.

Comments

We recommend ESMA take into account that the processing and confirmation of transactions in FX derivatives is currently not as centralized or automated as in other asset classes. For example, given the lack of a central infrastructure for the pairing of trades, agreeing and sharing a unique UTI is more challenging for FX derivatives compared to other asset classes such as interest rates or credit where such central infrastructure is established and widely adopted.

Markit has been working closely with market participants to launch several risk reducing and efficiency enhancing services for FX derivatives. Such services include a central matching platform with connectivity to several CCPs for FX NDFs,⁶ an FX legal confirmation and an FX option electronic exercise service,⁷ as well as an SEF/IDB affirmation/NOE service. We offer these newly created services in addition to our existing point-to-point FX connectivity services that have been serving these markets for many years.

Based on our experience in supporting the introduction of clearing requirements in various other jurisdictions as well as in building the above FX derivatives specific services please find below our responses to ESMA’s questions.

Question 3: In view of the criteria set in Article 5(4) of EMIR, do you consider that the determination of this class addresses appropriately the objective of reduction of the systemic risk associated to NDF derivatives?

We believe that the product scope of FX NDFs to be subject to the clearing obligation as proposed by ESMA is sensible and would appropriately address the objective of reducing systemic risk. However, we also believe that the international consistency of clearing mandates is a key ingredient to allow for a smooth implementation of the clearing requirement in the various jurisdictions. It will therefore be important for ESMA and the CFTC to harmonize the scope of their FX NDF clearing proposals.

The CFTC’s Global Markets Advisory Committee recently discussed issues related to the clearing of FX NDFs.⁸ Although the publication of actual proposals is expected only around the end of this year, the CFTC stated that it was considering limiting its mandatory clearing determination to the most liquid FX NDF currency

⁴ Our processing platforms are currently connected, or are planning to connect, to more than 10 CCPs around the globe and in various asset classes.

⁵ For the reporting of derivatives transactions to Trade Repositories, the MarkitSERV platforms are now live in Europe, the United States, Japan, Hong Kong, Australia, and Singapore.

⁶ This service has been live since 2011.

⁷ This service will be phased in starting in Q1/2015.

⁸ CFTC Event: Advisory Committee Meeting October 9, 2014. http://www.cftc.gov/PressRoom/Events/opaevent_gmac100914

pairs.⁹ In the interest of “strengthening international regulatory convergence”¹⁰ and avoid imposing unnecessary burden on market participants we encourage ESMA to work closely with the CFTC to agree on a harmonized set of FX NDF currency pairings that shall be exposed to the clearing obligation.

Question 7: Do you consider that the proposed dates of application ensure a smooth implementation of the clearing obligation? Please explain why and possible alternatives.

ESMA highlights in the CP that matching providers are utilized for electronic affirmation of FX NDFs. Specifically, it states that “electronic affirmation is performed upstream to the CCP by matching providers” and that “trades executed on platform are currently received via the matching provider ...”.¹¹

To enable a “smooth implementation” of the clearing obligation in Europe and to ensure that ESMA’s analysis of the criteria underlying the clearing determination remains valid, market participants must be able to continue to use established connectivity to CCPs once the clearing obligation is implemented.¹² Although there has been discussion regarding the “access of Trading Venues to CCPs” neither Article 35 of MiFIR nor ESMA’s related DP acknowledged the vital role of third party matching and connectivity providers. We believe that failure to recognize the role of such third party providers in ESMA’s implementing measures would increase the risk of CCPs abusing their market power by potentially refusing access to third parties that want connect to them on behalf of counterparties and/or TVs. This risk will be particularly pronounced where CCPs operate their own processing platforms as they could, by requiring TVs and/or counterparties to only use those for establishing connectivity to them, directly foster the development of their own vertical silo or in asset classes where central clearing is only provided by a small number of CCPs, or even just one. By undermining market participants’ level of preparedness for the introduction of the clearing obligation such behaviour would also question the validity of ESMA’s analysis of the criteria underlying the clearing determination, in addition to standing in direct conflict with the spirit of Article 35 of MiFIR.

ESMA should note that under the United States’ Dodd-Frank Act some CCPs have interpreted “open access” requirements to encompass third party connectivity providers¹³ while others explicitly allow third party connectivity providers open access under their rules.¹⁴ To prevent the occurrence of competition-restricting practices in this respect in Europe, we recommend that ESMA should also reflect established market practices

⁹ Brazilian Real, Chinese Yuan, Indian Rupee, Korean Won, Russian Ruble, and Taiwan Dollar. Additionally the CFTC is considering the Peruvian Nuevo Sol.

¹⁰ ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 1), par. 73.

¹¹ CP par. 38.

¹² See Markit’s response ESMA’s Consultation Paper on the Clearing Obligation under EMIR (no 1) and (no 2).

¹³ “ICE Clear Credit shall ensure that, consistent with the requirements of [Commodity Exchange Act] Section 2(h)(1)(B) and Securities Exchange Act Section 3C(a)(2), there shall be open access to the clearing system operated by ICE Clear Credit pursuant to these Rules for all execution venues (including, without limitation, designated contract markets, national securities exchanges, swap execution facilities and security-based swap execution facilities) and trade processing platforms...” ICC Rulebook, Rule 314, available at https://www.theice.com/publicdocs/clear_credit/ICE_Clear_Credit_Rules.pdf (last revised Nov. 18, 2013). Commodity Exchange Act section 2(h)(1)(B)(ii)(B)’s (as amended by Dodd–Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) section 723) open access requirement states that DCOs must “provide for non-discriminatory clearing of a swap (but not a contract of sale of a commodity for future delivery or option on such contract) executed bilaterally or on or through the rules of an unaffiliated designated contract market or swap execution facility.”

¹⁴ “See CME Rulebook Rule 8H17, available at <http://www.cmegroup.com/rulebook/CME/I/8H/8H.pdf> (“CME shall provide open access to its CDS Contract clearing services for any execution venue or trade processing or confirmation service that desires to facilitate the submission of CDS Product transactions to the Clearing House for clearing, subject to the Clearing House’s normal operational requirements applied to all such third-party services[.]”). See also LCH Rulebook, available at http://www.lchclearnet.com/Images/Voluntary%20Submission%20of%20Rulebook%20and%20Supporting%20Materials_tcm6-62205.pdf (Definition of “Approved Trade Source System” as “a system or facility, such as an exchange, a clearing house, a swap execution facility, a designated contract market or other similar venue, approved by the Clearing House for executing Transactions and/or presenting such Transactions to the Clearing House.”). LCH Rule 2A.3.3 provides that “Currently the Approved Trade Source Systems designated by the Clearing House for SwapClear are MarkitWire, Bloomberg and Tradeweb. Where the Clearing House approves additional Approved Trade Source Systems, it will notify Clearing Members via a member circular.”

and workflows in its various implementing measures. Specifically, ESMA should clarify that the requirement for CCPs to provide open, non-discriminatory access to TVs equally applies for the provision of access to *third party providers that act (and establish connectivity) on behalf of TVs or counterparties*. In addition, in asset classes where the number of CCPs providing central clearing is small, or just one, we encourage ESMA to reflect the elevated risks that this might create for the implementation process in its clearing determination.¹⁵

We further believe that ESMA should consider establishing procedural safeguards to ensure non-discriminatory access to clearing for all classes of counterparties, including those using third-party connectivity providers. In this context, ESMA should clarify, for example, that CCPs should submit new rules and rule amendments relevant in relation to access to their competent authority for their review.^{16,17}

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We hope that our above comments are helpful to ESMA. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. In the event you may have any questions, please do not hesitate to contact us.

Yours sincerely,



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¹⁵ We note ESMA's view that, even if "the existence of a single CCP to clear the class does not lead to an automatic exclusion of the that class from the scope of the clearing obligation determination" it "should not be understood as meaning that the number of CCPs clearing the same class is irrelevant for the purpose of determining the classes." See CP Par. 89. We believe that introducing a clearing obligation in an asset class with only a small number of CCPs creates significant systemic risk issues and the number of CCPs should hence play an important role in ESMA's clearing determination.

¹⁶ Regulation (EU) No 648/2012 at (51)

¹⁷ Moreover, the relevant new policy changes should be required to be subjected to competent authority review, i.e. any change in policy, practice, or interpretation affecting in any material respect the CCP's operations should be deemed to be a proposed rule change. See e.g., SEC Rule 19b-4(c) (17 CFR 240.9b-4), available at <http://www.law.cornell.edu/cfr/text/17/240.19b-4>.