

Becky Young
Policy, Risk and Research Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Submitted via wholesalecompetition@fca.org.uk

London, October 9, 2014

Wholesale sector competition review – Call for inputs

Dear Sirs,

We welcome the publication of the FCA's Call for inputs on the *Wholesale sector competition review* (the "**Call for inputs**" or "**CI**") 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, 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 100 comment letters to regulatory authorities around the world and have participated in numerous roundtables. We also regularly provide the 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

By way of background, the FCA should be aware that our derivatives processing platforms facilitate the confirmation, matching and processing of OTC derivatives across regions and asset classes, including interest rate, credit, equity and foreign exchange, 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 transactions that they have entered into, b) provide them with connectivity

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. Please see www.markitserv.com for additional information.

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

to CCPs,⁴ trading venues and inter-dealer brokers, trade repositories, and the whole range of counterparties, including buy-side and sell-side, and d) report the relevant transaction and counterparty details to trade repositories under newly established regulatory requirements.⁵ Such services that are offered also by various other providers are widely used by participants in the global OTC derivatives markets today and are recognised as tools to increase efficiency, reduce cost, and secure legal certainty. With globally over 1,500 firms using the various MarkitSERV platforms that process, on average, 80,000 OTC derivative transaction processing events every 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.

Based on our experience in supporting market participants with the introduction of newly established regulatory requirements for OTC derivatives globally, please find below our response to Question 2 on competition issues in the market for trading and clearing services.

Comments

Q2: We welcome evidence on whether there are any competition issues in the market for trading and clearing services, both for OTC and venue traded products. For example:

- ***Whether there are instances in which standalone trading venues and CCPs are limited in their ability to compete with silo structures.***
- ***Whether there are instances of barriers to entry that prevent competition from new entrants.***

We appreciate the FCA's intention to identify and investigate possible competition issues in the market for trading and clearing.⁶ We believe that there might indeed be instances in the market for clearing and trading for OTC derivatives where barriers to entry exist that limit the ability of standalone trading and/or clearing venues to compete with vertically-integrated silos. We believe that the discussion around "access" to clearing and trading and how it applies to third party connectivity providers plays a key role in addressing these issues.

Our experience as provider of connectivity services in the global OTC derivatives markets has shown that for clearing and trading to be competitive in a horizontal model, market participants and market infrastructures need to be able to establish robust connectivity with each other in a timely and cost effective manner. Elevated costs or unnecessary delays in establishing such connectivity can represent a material barrier to entry for new entrants, for example start-up execution venues. Platform-neutral connectors such as MarkitSERV are widely used and recognized by counterparties, execution venues, and CCPs alike as tools that enhance the efficiency, reduce the cost and lower the risk of a horizontal model in the OTC derivatives markets, herewith fostering competition on the levels of execution and clearing.⁷ Importantly, experience in other jurisdictions has shown that the ability of market participants to rely on such platform-neutral connectivity services to CCPs is a key factor to achieving an efficient implementation of a clearing requirement for OTC derivatives. We believe

⁴ Our processing platforms are currently connected to, 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 "For example, a vertically integrated entity may restrict access to certain services that it provides, or not provide them in a proportionate manner; for example if participants on a particular trading venue are unable to connect to a CCP that exists as part of a silo arrangement on a reasonable basis. This may make it more difficult for stand-alone trading venues to compete." CI, Par. 3.11.

⁷ As we have stated in our recent response to ESMA's MiFID II/ MiFIR Discussion Paper, available at http://www.esma.europa.eu/system/files/esma_mifid2_dp_markit_replyform.doc, we are generally supportive of the access requirements introduced in Articles 35 to 37 of MiFIR as means to increase competition in European financial markets. Recital 40 of MiFIR asserts that "access to licences is critical to facilitate access between trading venues and CCPs under Articles 35 and 36 of MiFIR as otherwise licensing arrangements could still prevent access between trading venues and CCPs that they have requested access to. The removal of barriers and discriminatory practices is intended to increase competition for clearing and trading of financial instruments in order to lower investment and borrowing costs, eliminate inefficiencies and foster innovation in Union markets".

that this should also be a significant concern for the FCA given the upcoming implementation of the clearing obligation in Europe under EMIR.⁸

Whilst we welcome that the recently finalized MiFIR/MiFID II legislation contains provisions in relation to the provision of access to clearing and trading⁹ we are concerned that it does not acknowledge the vital role of third party connectivity providers in this context with the discussion evolving solely around “access of Trading Venues to CCPs.” Failure to recognize the role of third party connectivity providers increases the risk of CCPs abusing their market power by potentially refusing access to third parties that want to connect to them on behalf of counterparties and/or trading venues.¹⁰ This risk will be particularly pronounced where CCPs operate their own processing platforms (as they could, by requiring trading venues and/or counterparties to only use those for establishing connectivity to them, directly foster the development of their own vertical silo) and in asset classes where central clearing is only provided by a small number of CCPs, or even just one.¹¹

To prevent the occurrence of competition-restricting practices in this respect in the UK or Europe, we recommend that regulations reflect established market practices and workflows in the various implementing measures. Specifically, it should be clarified that the requirement for CCPs to provide open, non-discriminatory access to trading venues equally applies for the provision of access to *third party providers that act (and establish connectivity) on behalf of trading venues or counterparties*. We believe that it will be important for the FCA to also 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 it should be clarified, for example, that CCPs should submit new rules and rule amendments relevant in relation to access to their competent authority for their review.^{12, 13}

⁸ ESMA published consultations on the mandatory clearing obligations for certain derivatives. See ESMA Final Report: Draft technical standards on the Clearing Obligation – Interest Rate OTC Derivatives. October 2014; ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 2). July 11, 2014. ESMA Consultation Paper on the Clearing Obligation under EMIR (no. 3). October 2014.

⁹ See Article 35 of MiFIR and ESMA’s Discussion Paper.

¹⁰ The FCA provided the following example: “Another example might be silo structures bundling services provided across the transaction chain and rebalancing the proportion of the charge relating to each activity. For example, clearing or trading fees may be reduced with offsetting increases elsewhere. This may provide some benefits, but may also create barriers to entry or expansion for standalone trading venues and CCPs, which could be further reinforced via network effects.” CI, Par. 3.13.

¹¹ It is worth highlighting that under the United States’ Dodd-Frank Act, some CCPs have interpreted “open access” requirements to encompass third party connectivity providers. Currently, some CCPs interpret “open access” to cover third party connectivity providers, while the remaining explicitly grant access to third parties. “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.” “See CME Rulebook Rule 8H17, available at <http://www.cmegroup.com/rulebook/CME/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.”

¹² Regulation (EU) No 648/2012 at (51)

¹³ 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>.

In addition, in asset classes where the number of CCPs providing central clearing is small or just one, regulations should reflect the elevated risks, including systemic risk and heightened risk of market power-related competitive concerns, that this might create for the implementation process in its clearing determination. ESMA states that even if “the existence of a single CCP to clear the class does not lead to an automatic exclusion of 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.”¹⁴ 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.

* * * * *

We hope that our above comments are helpful to FCA. 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,



Marcus Schuler
Head of Regulatory Affairs
Markit
marcus.schueler@markit.com

¹⁴ See ESMA’s Consultation Paper on the Clearing Obligation under EMIR (no.1), Par. 145.