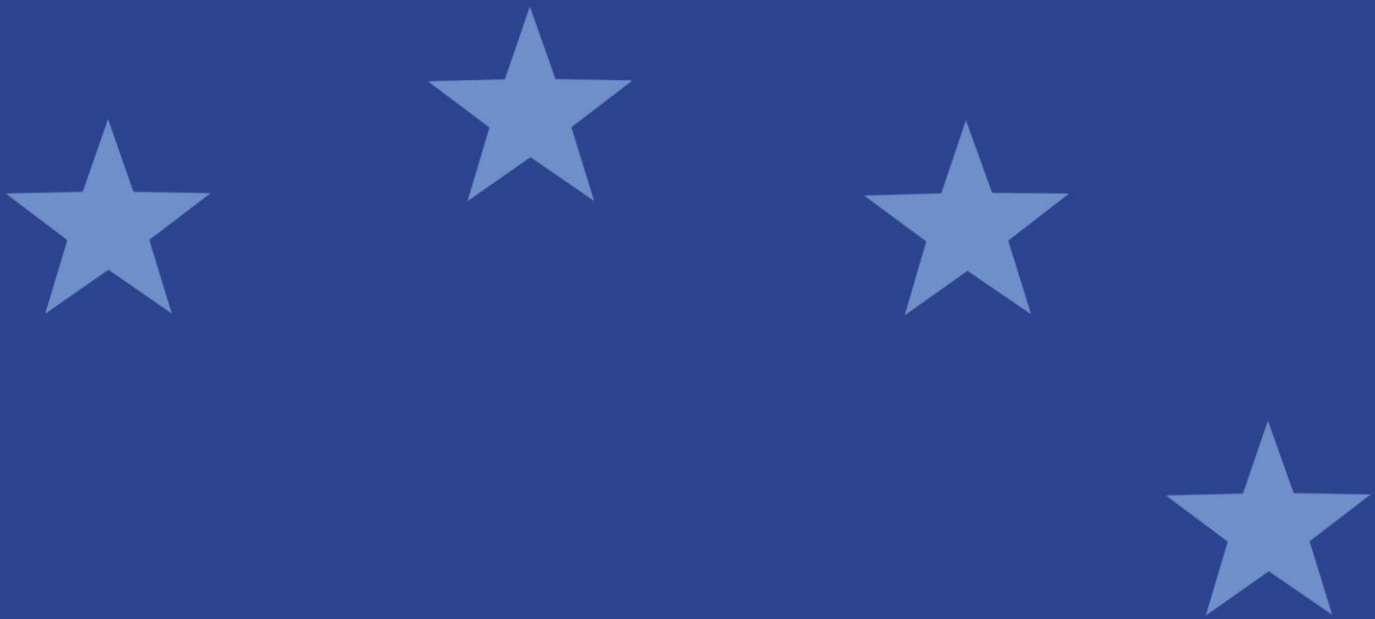




European Securities and  
Markets Authority

# Final Report

**Alignment of MiFIR with the changes introduced by EMIR Refit**





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**Acronyms and definitions used**

CDR on the DTO	Commission Delegated Regulation (EU) 2017/2417 of 17 November 2017 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the trading obligation for certain derivatives
CO	Clearing Obligation
CP	Consultation Paper
DTO	Derivatives Trading Obligation
EC	European Commission
EMIR	European Market Infrastructures Regulation Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories
EMIR Refit	Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories
EU	European Union
ESMA	European Securities and Markets Authority
FC	Financial Counterparty
MiFID II	Markets in Financial Instruments Directive (recast) Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU
MiFIR	Markets in Financial Instruments Regulation Regulation 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012
MTF	Multilateral Trading Facility
NCA	National Competent Authority
NFC	Non-Financial Counterparty
OTC	Over-the-counter
OTF	Organised Trading Facility
Q&A	Question and answer
RTS	Regulatory Technical Standard

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# 1 Executive Summary

## Reasons for publication

Under EMIR Refit, the Commission shall prepare a report assessing the necessity and appropriateness of aligning the trading obligation for derivatives under MiFIR with changes made under EMIR Refit to the clearing obligation for derivatives. This concerns, in particular, the scope of the entities that are subject to the clearing obligation. That report shall be submitted to the European Parliament and to the Council, together with any appropriate proposals, by 18 December 2020, on the basis of a report by ESMA to be submitted to the Commission by 18 May 2020. This document has been prepared after a public consultation.

## Contents

Section 2 explains the background to this report. Section 3 describes the amendments made under EMIR Refit that have an impact on the application of the derivatives trading obligation under MiFIR, for financial counterparties and for non-financial counterparties. Section 4 recalls the short-term solution adopted by ESMA to address the misalignment of the scope of entities subject to the clearing and the trading obligations on a temporary basis. Section 5 assesses the merits and drawbacks of aligning the scope of counterparties subject to the clearing and the trading obligations. Section 6 examines other changes to MiFIR that could be proposed in the context of the changes introduced by EMIR Refit. Section 7 details the final recommendations that ESMA is making to the European Commission. Annex 1 provides the detailed feedback to the consultation paper and Annex 2 recalls the mandate.

## Next Steps

This report is submitted to the European Commission and is expected to feed into the report that the Commission will prepare for the European Parliament and the Council on the necessity and appropriateness of aligning the trading obligation for derivatives under MiFIR with changes made under EMIR Refit to the clearing obligation for derivatives.

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## 2 Introduction

1. The European Market Infrastructure Regulation (EMIR) and the Markets in Financial Instruments Directive/Regulation (MiFIDII/MiFIR) form part of the European regulatory response to the financial crisis. Within the EU, EMIR and MiFIR fulfil the G20 commitments on improving the safety and transparency of over-the-counter (OTC) derivatives market as agreed in Pittsburgh in September 2009.
2. In particular, the clearing obligation (CO) under EMIR, and the derivatives trading obligation (DTO) under MiFIR, address the Pittsburgh's engagement that all standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties.
3. EMIR has recently been amended via a new regulation referred to as "EMIR Refit"<sup>1</sup>, which intends to simplify certain provisions, and adopt a more proportionate approach. This is in line with the Commission's Regulatory Fitness and Performance programme, one intention being that Union policies achieve their objectives more efficiently, by reducing regulatory and administrative burdens where possible.
4. The changes introduced by EMIR Refit concern inter-alia the scope of counterparties subject to the CO: EMIR Refit introduces an exemption from the CO for small financial counterparties and modifies the mechanism to determine the obligations of non-financial counterparties above the clearing threshold (NFC+).
5. EMIR Refit was not accompanied by direct amendments to MiFIR, which currently leads to a misalignment between the scope of counterparties subject to the CO and to the DTO. However, in light of the close interconnection between those two obligations, EMIR Refit requires the European Commission (EC) to prepare a report assessing "the necessity and appropriateness of aligning the trading obligation for derivatives under Regulation (EU) No 600/2014 with changes made under Regulation (EU) 2019/834 to the clearing obligation for derivatives, in particular to the scope of the entities that are subject to the clearing obligation." (Article 1(24)(c) and (d) of Refit, which amends Article 85 of EMIR).
6. The EC's report shall be submitted to the European Parliament and to the Council by 18 December 2020, on the basis of an ESMA report to be submitted to the EC by 18 May 2020. For reasons further explained in Section 4, ESMA is submitting its contribution to the EC's report a few months in advance of the set deadline and trusts that the Commission will endeavour to swiftly deliver its report to the European Parliament and to the Council.

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<sup>1</sup> Regulation (EU) 2019/834 of the European Parliament and of the Council of 20 May 2019 amending Regulation (EU) No 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories

7. The proposals made in this report have been set out in a [Consultation Paper](#)<sup>2</sup> published on 4 October 2019, to which ESMA received 18 responses (summarised in Annex 1).

### **3 Amendments under EMIR Refit that have an impact on the MiFIR DTO**

#### **3.1 Amendments in relation to Financial Counterparties**

8. One of the crucial changes introduced by EMIR Refit is the distinction between two types of financial counterparties (FC): those who may pose an important systemic risk to the financial system (thereafter FC+), and the others (FC-). The distinction between the two is made by reference to their volume of activity in OTC derivatives, compared to thresholds defined in the law. EMIR Refit acknowledges, in Recital 7, that the volume of activity in OTC derivatives markets of FCs- is too low for central clearing to be economically viable.
9. As a result, since the entry into force of EMIR Refit, the CO only applies to FCs+, i.e. financial counterparties that either (1) exceed any of the clearing thresholds specified pursuant to point (b) of Article 10(4) of EMIR; or (2) decide not to calculate whether they exceed those thresholds.
10. Such a change has been introduced in EMIR via a new Article 4a, which defines how FCs should determine whether they are subject to the CO, and what their obligations are. In addition, in Article 4 of EMIR (which specifies the transactions subject to the CO) the reference to FC has been modified from “financial counterparties” to “financial counterparties that meet the conditions set out in the second subparagraph of Article 4a(1)”.
11. Under MiFIR, the scope of the DTO for FCs is defined with a cross-reference to the definition of FC in EMIR (i.e. “financial counterparties as defined in Article 2(8) of [EMIR]”).
12. Given that EMIR Refit does not amend MiFIR, the scope of FCs subject to the DTO and the CO is currently not aligned. In practice, this means that small financial counterparties are exempted from the CO while still being subject to the DTO.
13. Respondents to the CP all agreed with this analysis (see Annex 1, Q1).

#### **3.2 Amendments in relation to Non-Financial Counterparties**

14. Under the former version of EMIR, non-financial counterparties (NFC) were subject to the CO, in all asset classes, when their volume of OTC activity exceeded *any* of the clearing thresholds (which are defined per asset class). EMIR Refit amends that mechanism, to

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<sup>2</sup> Consultation Paper – Alignment of MiFIR with the changes introduced by EMIR Refit, 4 October 2019 (ESMA70-156-1555)

take into account the fact that NFCs are less interconnected than FCs, and that they are often predominantly active in only one class of OTC derivatives.

15. The activity of NFCs poses less systemic risk to the financial system than the activity of FCs, in the sense that the risk that they may pose tends to be concentrated in the asset class in which they are mainly active.
16. As a result, since the entry into force of EMIR Refit, NFCs calculating their positions are subject to the CO only in the asset classes in respect of which the result of the calculation exceeds the clearing thresholds.
17. In practice, in Article 4 of EMIR, which defines the conditions on the counterparties for a contract to be subject to the CO, the references to NFC have been modified (by Refit) from “a non-financial counterparty that meets the conditions referred to in Article 10(1)(b)” to “a non-financial counterparty that meets the conditions set out in the second subparagraph of Article 10(1)”.
18. Under MiFIR, the scope of the DTO for NFCs is defined with a cross-reference to the NFCs+ in EMIR (i.e. “non-financial counterparties that meet the conditions referred to in Article 10(1)(b) [of EMIR]”).
19. The issue is that Article 10(1)(b) of EMIR does not have the same meaning in the old and the new version of EMIR, and therefore the references in MiFIR to “non-financial counterparties that meet the conditions referred to in Article 10(1)(b) [of EMIR]” no longer point to the correct provisions under the revised version of EMIR.
20. The new concept introduced by Refit, according to which NFCs become subject to the CO only for those classes where they exceed the clearing thresholds (or in case they choose not to make the calculation, for all asset classes), is introduced in the second subparagraph of Article 10(1) and in Article 10(1)(c), but not in Article 10(1)(b).
21. The scope of NFCs subject to the DTO since the entry into force of EMIR Refit therefore appears to be misaligned with EMIR and should be corrected to ensure the same treatment for the purposes of the CO and the DTO.
22. Respondents to the CP all agreed with this analysis (see Annex 1, Q2).

## **4 Interim solution – ESMA Public Statement**

23. In the period preceding the entry into force of EMIR Refit, stakeholders have urged ESMA to analyse the issue of the misalignment of the scope of counterparties between the EMIR CO, and the MiFIR DTO, and the possible implementation challenges that this misalignment creates for counterparties exempted from the CO.
24. Those challenges are expected to be analysed in the EC report to the European Parliament and to the Council, on the basis of this report from ESMA. However, there remained a relatively long period of uncertainty between the entry into force of Refit, and the outcome of the above-mentioned reports by the EC and ESMA. Such outcome could either be a



proposal to change MiFIR to reflect the amendments introduced in EMIR Refit (which would inevitably be a process taking a significant amount of time), or a confirmation that such changes are not deemed necessary or appropriate.

25. To address the situation in a consistent manner in the Union in this interim period, ESMA published on 12 July 2019 a [statement](#)<sup>3</sup> on MiFIR implementation considerations regarding the DTO following the entry into force of EMIR Refit.
26. The statement advises National Competent Authorities (NCAs) not to prioritise their supervisory actions in relation to the DTO towards counterparties exempted from the CO following the entry into force of EMIR Refit.
27. Additionally, for FCs in Category 3 which are subject to the CO, the statement clarifies that the date of application of the DTO should be the same as the new date of application of the CO as amended by EMIR Refit. This date of application should hence be four months following the notification from FCs to ESMA and NCAs as required under EMIR Refit, rather than 21 June 2019.
28. One respondent to the CP indicated that the clarification with respect to the date of application of the DTO for counterparties in Category 3, as clarified in the statement, was not reflected in the ESMA [Public Register](#) on the trading obligation, where such date of application was still 21 June 2019. ESMA will amend the Public Register to take this comment into account.
29. In general, respondents to the CP welcomed the publication of this statement as there had been some ambiguity around the implications of EMIR Refit on MiFIR immediately after the entry into force of Refit.
30. Finally, in order to minimise the validity period of the supervisory statement, ESMA decided to submit its report to the European Commission ahead of the legal deadline.

## 5 Assessment of the necessity and appropriateness to align the scope of counterparties

31. To recall, ESMA's mandate for the report to the EC is to assess "the necessity and appropriateness of aligning the trading obligation for derivatives under Regulation (EU) No 600/2014 with changes made under Regulation (EU) 2019/834 to the clearing obligation for derivatives, **in particular to the scope of the entities that are subject to the clearing obligation.**" This section focuses on the latter point only, i.e. the alignment of the scope of counterparties.

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<sup>3</sup> Public Statement "MiFIR implementation considerations regarding the trading obligation following the entry into force of EMIR Refit", ESMA70-156-1436, 12 July 2019

## 5.1 Appropriateness to align the scope in light of G20 objectives

32. As identified in the CP, the immediate impact of aligning the scope of counterparties subject to the CO and the DTO would be to exempt more counterparties from the DTO and hence to limit the volume of trading that is executed on trading venues. Exempted counterparties would have no legal obligation to trade on venue and instead are likely to continue trading those derivatives OTC. Such outcome would appear to be at odds with the G20 commitment to increase the level of standardized OTC derivative contracts traded on exchanges or electronic trading platforms.
33. The reaction of market participants to this argument was split: a number of them used as counterargument that the G20 objective is itself caveated to be only applicable “where appropriate”. In their view, the mere fact that a contract is not centrally cleared renders the application of the DTO for such contract “inappropriate”. Others agreed that reducing further the scope of counterparties subject to the DTO was contrary to the G20 objectives and to those of MiFID II/MiFIR in general i.e. increasing transparency and efficiency in price-formation, both of which are beneficial for investors. Some mentioned that in this respect the EU is already lagging behind when compared to other jurisdictions where the scope of the CO and DTO are broader.
34. ESMA considers that the G20 commitments are key and should be carefully taken into consideration when deciding on adaptations of the applicable regulatory regime for OTC derivatives, especially having in mind the current level of clearing rates on asset classes subject to the CO<sup>4</sup>, which could suggest that exempted counterparties still account for a non-negligible portion of overall trading activity in OTC derivatives.
35. However, as developed further in Section 7, ESMA considers that other, potentially more appropriate tools are available to regulators to make sure that the G20 commitments in relation to the DTO are appropriately met in the EU.

## 5.2 Arguments in favour of aligning the scope of counterparties

### 5.2.1 The policy intention before EMIR Refit

36. Before EMIR Refit, the legal framework pointed at a policy intention to align the scope of counterparties subject to the CO and the DTO. The use of cross-references between EMIR and MiFIR initially ensured a perfect alignment between the counterparties subject to both obligations.
37. Furthermore, Article 28(2) of MiFIR defines how the DTO applies when EU counterparties enter into transactions with third-country firms. Those third-country firms are referred to as “third-country financial institutions or other third-country entities that would be subject to

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<sup>4</sup> Clearing ratio of 63% for interest rate derivatives and 25% for credit derivatives in 2018Q4 (Source: [ESMA Annual Statistical Report on EU Derivatives Markets](#), 2019). The report is based on 2018 data hence before Category 3 counterparties became subject to the clearing obligation. Clearing ratios are expected to increase in 2019Q4.

the clearing obligation if they were established in the Union.” This further demonstrates the linkages between the CO and the DTO.

38. In addition, the framework of the CO and the DTO was construed according to a time sequence where first, counterparties became subject to the CO for a specific set of instruments, and then to the DTO for the same or a potentially more granular set of instruments.
39. Finally, the implementation dates of the DTO have been chosen to ensure that counterparties become subject to the DTO no sooner than when they become subject to the CO.
40. ESMA has not identified specific new circumstances or market developments which would justify a deviation from this initial construction, i.e. the introduction of differences in the scope of counterparties.
41. In particular, ESMA does not see any logical explanation why the construction of the two obligations envisage that the CO applies first and can apply to a broader set of instruments, but it cannot apply to certain counterparties while the DTO would apply to those counterparties. ESMA does also not see any logic on why third country counterparties would not be subject to the DTO if they are not subject to the CO, while certain EU counterparties would.
42. There was a very broad consensus in the responses to the CP supporting this argument (Annex 1, Q5). It was also mentioned that aligning the scope of counterparties for two requirements which are closely interconnected leads to a greater level of consistency and a simplification of the legal framework which is perceived as complex enough – an assessment with which ESMA tends to agree.

### 5.2.2 The potential de-facto CO for exempted counterparties

43. Article 29 of MiFIR requires that derivatives concluded on a regulated market are cleared by a CCP, but this provision does not apply to the other types of trading venues where derivatives are traded, i.e. multilateral trading facilities (MTFs) and organised trading facilities (OTFs). In the EU, derivatives subject to the DTO currently only appear to be available on MTFs and OTFs<sup>5</sup>, and not on regulated markets.
44. However, some of the MTFs and OTFs which offer trading of derivatives subject to the DTO may require all counterparties (including those exempted from the CO) to centrally clear those contracts. As a result, a standalone DTO (without a CO) could lead certain counterparties to a forced CO if they transact through these MTFs or OTFs. And if there is an alternative MTF or OTF that does offer trading for some of these contracts as non-

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<sup>5</sup> Table 2.1 of the Public Register for the derivatives trading obligation under MiFIR (ESMA70-156-300) lists all the EU venues where the derivatives subject to the DTO are available for trading. No regulated market features on that list.

cleared, then the DTO without the CO could limit the number of TVs certain counterparties could trade on.

45. Should MTFs and OTFs find it impossible to accommodate different post-trade mechanisms for exempted counterparties, the existence of a standalone DTO could create, in practice, a quasi-obligation to clear for counterparties exempted therefrom under EMIR Refit. Even though incentives to centrally clear on a voluntary basis can be viewed as a positive development in terms of overall reduction of systemic risks, this in effect would contradict the very objective of EMIR Refit, which is to exempt from the CO those counterparties that do not pose a high systemic risk to the system.
46. Respondents to the CP generally supported the idea that applying the DTO to counterparties exempted from the CO would eventually scope them back into the CO, hence contradicting the initial intention of Refit (Annex 1, Q5).
47. However, the responses to Q3 (which referred to the development of on-venue trading for uncleared contracts and potential challenges for trading venues) evidenced two contradicting views which are difficult to reconcile:
48. On one hand, some explained that the main obstacle to the development of on-venue trading for contracts which are not CCP-cleared was the pricing issue. According to those, trading venues have difficulties in pricing non-cleared transactions because such pricing partly depends on collateral arrangements (which are uniform in the case of cleared derivatives but depend on an individual credit support annex for non-cleared derivatives);
49. On the other hand, some mention an already significant offer of non-cleared contracts on-venue and material volumes of non-cleared contracts executed on MTFs and OTFs. Some clients have decided to voluntarily trade on-venue even when not subject to the CO/DTO to benefit from additional transparency, liquidity, electronic workflow and straight-through-processing (STP).
50. Being confronted with two opposing analyses of the same situation, ESMA considers that the argument of the “de-facto clearing obligation” might not be supported by sufficient evidence, hence it should be weighted carefully in the overall assessment of the necessity and appropriateness to align the scope of counterparties.

### 5.2.3 Suspension of the CO leading to a suspension of the DTO

51. In addition, Recital 14 of EMIR Refit explains why the suspension of the CO could also trigger (subject to specific conditions) the suspension of the DTO, i.e. “The suspension of the clearing obligation might prevent counterparties from being able to comply with the trading obligation.” This Recital tends to already introduce the idea that the absence of a CO might create operational issues for counterparties to comply with the DTO. Since this concept of a temporary suspension of the CO having an impact on the DTO is already embedded in EMIR it is difficult to see why in the absence of a CO in the first place the DTO should nevertheless apply.

52. This argument is however nuanced by the fact that the suspension of the CO does not automatically trigger the suspension of the DTO. Instead, there are additional conditions for such dual-suspensions, namely that the suspension of the CO is considered by ESMA to be a material change in the criteria for the DTO to take effect. To recall, those criteria are (1) the existence of at least one trading venue offering the class of derivatives for trading; and (2) the existence of sufficient third-party buying and selling interest so that the derivatives are considered sufficiently liquid to trade only on eligible venues (Article 32(2) of MiFIR).
53. The responses to the CP did not provide any comment in relation to this element, which ESMA continues to consider valid.

#### 5.2.4 Reducing the administrative and regulatory burden for FC-

54. As explained in the recitals of EMIR Refit, the limitation of the scope of counterparties subject to the CO is justified by two main arguments: (1) the systemic risk (or absence thereof) that certain counterparties pose in the financial system; and (2) the general policy intention to simplify certain provisions, and to adopt a more proportionate approach thereto by reducing the administrative and regulatory burden where possible.
55. The argument on systemic risk is of less relevance in the context of the DTO, as the reduction of systemic risk is not the overarching principle guiding the application of the DTO (as opposed to the CO).
56. However, the objective of reducing the administrative and regulatory burden for counterparties could be considered as valid both for the DTO and the CO. This should however be nuanced by the fact that the administrative burden of setting up clearing arrangements to meet the CO is certainly higher than that of setting up access with a trading venue to meet the DTO.
57. Most stakeholders responding to the CP considered that reducing the administrative and regulatory burden for FC- was a valid justification to the alignment of the scope of counterparties, while acknowledging that the DTO was less burdensome than complying with the CO.
58. The argumentation related to the administrative burden was however challenged by a few stakeholders: whilst not contesting that compliance with the DTO for FC- entails some costs for them at individual level, this should be nuanced by the costs for the financial system as a whole of not having them under the scope of the DTO (persistence of counterparty credit risks for uncleared contracts, under collateralisation, lack of transparency, complex bilateral market structure, inappropriate risk management).
59. In the same vein, one trading venue experienced several cases of market participants which started trading on-venue on a voluntary basis and quickly realised its benefits in terms of pricing, liquidity and transparency. In other words, even though the DTO can be perceived as costly and burdensome for FC-, this would be outweighed by the benefits that on-venue trading would bring to those counterparties. As a result, relieving FC- from that obligation might not eventually play to their advantage.

60. Overall, ESMA's assessment is that the administrative burden for FC- is a valid, yet relatively weak, argument to justify aligning the scope of counterparties subject to the CO and the DTO.

### 5.2.5 The potential limited impact of the exemption of FC- from the DTO

61. The underlying assumption that formed the basis of the EMIR Refit proposal in relation to the exemption from the CO was that such exempted counterparties, although numerous in terms of head-count, only account for a small share of the total volume traded.

62. In this respect, reference can be made e.g. to ESMA's CP on the CO for FCs with a limited volume of activity<sup>6</sup>. Based on trade repository data, this report showed that in the interest rate derivative asset class, less than 500 counterparties (out of 6,000+) represented 99.4% of the activity. Similarly, in the credit derivative asset class, less than 400 counterparties (out of 2,000+) represented 98.6% of the activity.

63. This could support the argument that an exemption from the DTO, for counterparties exempted from the CO, should have a limited impact on the volumes traded on venues, while alleviating the burden for a large number of counterparties.

64. Several stakeholders disputed this reasoning and considered that such statement should be supported by a thorough impact assessment because:

- the above-mentioned analysis only refers to interest rate and credit derivatives (i.e. the classes now subject to the CO and DTO). In other asset classes such as equity derivatives, should they become subject to the CO/DTO in the future, the impact of exempting FC- would be much more significant due to a wider diversity of investors in this asset class;
- the above-mentioned analysis is based on stock rather than flow data. This data suffers from several flaws (e.g. it includes trades that were entered into before the entry into force of EMIR and MiFID II/MiFIR, it does not reflect the multilateral and netting compression activities that reduce the outstanding notional amounts) and does not allow for a proper understanding of the impact on trading venues' volumes.

65. ESMA concurs that the above-mentioned analysis only provides a partial indication of the potential effect of the exemption of FC- from the DTO. While agreeing that a thorough impact assessment would provide useful insights, this complex exercise would require the aggregation of several data sources and could not have been produced in the short timeframe under which this report had to be developed (as explained in more detail in Section 4). However, ESMA is making some suggestions in this respect in its final recommendation to the Commission (Section 7).

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<sup>6</sup> ESMA/2016/1125 published on 13 July 2016, Section 3

## 6 Assessment of the necessity and appropriateness to amend other aspects of MiFIR

66. ESMA's mandate in relation to the report to be submitted to the EC is not limited to the alignment of the scope of counterparties between the EMIR CO and the MiFIR DTO. It may cover other amendments introduced via EMIR Refit that have an impact on the MiFIR DTO. This section focuses on those possible other aspects.
67. Another significant change introduced by EMIR Refit relates to a new mechanism to suspend the CO (Article 6a of the revised version of EMIR). As explained in Recital (13) of EMIR Refit, it should be possible to temporarily suspend the CO in certain exceptional situations (e.g. the criteria on the basis of which specific classes of OTC derivatives have been made subject to the CO are no longer met, a CCP ceases to offer a clearing service for specific classes of OTC derivatives or for a specific type of counterparty, or it is considered necessary to avoid a serious threat to the financial stability in the Union.)
68. EMIR Refit further explains in Recital (14) that the MiFIR DTO is triggered when a class of derivatives is declared subject to the CO, and that suspension of the CO might prevent counterparties from being able to comply with the DTO. As a consequence, where the suspension of the CO has been requested, and where it is considered to be a material change in the criteria for the DTO to take effect, it should be possible for ESMA to propose the concurrent suspension of the DTO on the basis of EMIR, instead of MiFIR.
69. Under this mechanism, the suspensions of the DTO and the CO would function in parallel: they can be requested at the same time, become effective at the same time and be extended at the same time, for the same period. However, EMIR Refit does not introduce a standalone mechanism to suspend the DTO, without suspending the CO.
70. ESMA considers that there may be situations where the criteria on the basis of which specific classes of OTC derivatives have been made subject to the DTO are no longer met, while at the same time the criteria on the basis of which of those classes have been made subject to the CO are still met. This follows the logic underpinning the articulation between the CO and the DTO i.e. only a subset of OTC derivatives subject to the CO meets the relevant criteria to become eligible to the DTO.
71. For example, it is possible that a specific class of derivatives subject to the DTO is no longer offered for trading on any EU trading venue, hence forcing EU counterparties to comply with the DTO via trading venues established in equivalent third countries following an equivalence decision of the EC. Moreover, there could be a significant drop in the liquidity of derivatives traded on EU trading venues which may warrant a suspension of the DTO. Both situations could result in market disruptions.
72. This argument would therefore support amending MiFIR by creating a similar possibility to suspend the DTO on a standalone basis, without impacting the CO on the same classes of derivatives.

73. However, MiFIR already introduces a mechanism in Article 32(5) according to which ESMA may submit to the EC draft regulatory technical standards (RTS) to amend, suspend or revoke existing RTS, whenever there is a material change in one of the two criteria set out in Article 32(2) i.e. (1) the existence of at least one trading venue offering the derivatives for trading; and (2) the existence of sufficient third-party buying and selling interest so that the derivatives are considered sufficiently liquid to trade only on eligible venues.
74. However, that mechanism does not address the same situation as the suspension of the DTO/CO in at least two ways: (1) amending existing RTS is a lengthy exercise which is unlikely to be effective in case the DTO needs to be suspended swiftly; and (2) such amendments of existing RTS is triggered by only two specific conditions, which might not be sufficiently flexible to address unforeseeable market developments that would require a suspension of the DTO.
75. Most respondents to the CP supported the introduction of a stand-alone mechanism to suspend the DTO for the reasons expressed above. However, they consider that the conditions for such possibility to suspend the DTO should be clearly defined in the law (e.g. lack of liquidity, unavailability of trading platforms).
76. Stakeholders have not identified other aspects of MiFIR that should be aligned with amendments introduced by EMIR Refit.

## **7 Recommendations to the European Commission**

77. On the basis of the analysis above and the feedback received to the public consultation, ESMA is making three recommendations to the European Commission, which are explained in the following sections.

### **7.1 Aligning the scope of non-financial counterparties**

78. ESMA is of the view that the changes introduced by EMIR Refit to the scope of the clearing obligation for non-financial counterparties should be replicated in MiFIR.
79. There does not appear to be any alternative as the current wording of MiFIR points to a specific reference of EMIR which has changed after the entry into force of Refit. Hence the current cross-reference to EMIR, in MiFIR, is incorrect and should be modified.
80. To that effect, references to non-financial counterparties subject to both obligations should be exactly the same in EMIR and MiFIR. In Article 28 of MiFIR (“Obligation to trade on regulated markets, MTFs or OTFs”) references to “non-financial counterparties that meet the conditions referred to in Article 10(1)(b) of Regulation (EU) No 648/2012” should therefore be replaced with “non-financial counterparties that meet the conditions set out in the second subparagraph of Article 10(1) of Regulation (EU) No 648/2012”. Such reference should also be modified in Article 1(3) of MiFIR (“Subject matter and scope”).



## 7.2 Aligning the scope of financial counterparties

81. The analysis of the responses to the Consultation Paper suggests that careful consideration is given to two potentially conflicting views:

- On the one hand, ESMA continues to believe that aligning the scope of counterparties subject to the CO and the DTO was the initial policy intention of the co-legislators, as supported by the legal basis developed in the sections above. Having the same scopes not only seems logical from an economic point of view (it is operationally more efficient to trade on venue contracts that are centrally cleared), but also allows for legal consistency and a simpler legal framework;
- On the other hand, ESMA acknowledges that the operational barriers of trading on-venue contracts which are not subject to the clearing obligation might have been overestimated. ESMA is also receptive to the assertion that aligning the scope of counterparties means reducing the overall outreach of the DTO, hence limiting from the outset the benefits of the DTO to those small financial counterparties.

82. Having assessed those two elements, ESMA is of the view that other tools exist in the current legal framework to potentially increase the scope of the DTO. One possibility is, of course, to act on the *contracts* by reviewing the classes of OTC derivatives subject to the CO/DTO. ESMA can propose amendments to the RTS determining the scope of the CO and the DTO as part of its regular monitoring of the derivative classes that should be subject to those obligations.

83. Another possibility is to act on the *clearing thresholds*, defined in EMIR, which are used to segregate between financial and non-financial counterparties subject/not subject to the CO. In fact, those thresholds are subject to a periodic review by ESMA (which may propose amendments to the relevant regulatory technical standards if the review highlights the need to change these thresholds), taking into account in particular the interconnectedness of financial counterparties (4th paragraph of Article 10(4) of EMIR).

84. As a result, ESMA considers that the most appropriate way forward is to maintain the alignment in the scope of counterparties, and to continue using the overall assessment of the current application of the clearing and trading obligations as they currently stand, to identify potential needs to adjust the obligations both in terms of scope of contracts and counterparties. Such granular analysis should be based on EU data at the disposal of ESMA, namely OTC and on-venue derivatives data coming from Trade Repositories as well as information on counterparty classification coming from the notifications that financial and non-financial counterparties have been making to ESMA and their CA under Article 4a(1)(a) of EMIR since the entry into force of EMIR Refit.

85. To summarise, ESMA recommends that the changes introduced by EMIR Refit to the scope of the clearing obligation for financial counterparties is replicated in MiFIR. To that effect, references to financial counterparties subject to both obligations should be exactly the same in EMIR and MiFIR.

86. In Article 28 of MiFIR (“Obligation to trade on regulated markets, MTFs or OTFs”) references to “Financial counterparties as defined in Article 2(8) of Regulation (EU) No 648/2012” should therefore be replaced with “Financial counterparties that meet the conditions set out in the second subparagraph of Article 4a(1) of Regulation (EU) No 648/2012”. Such reference should also be modified in Article 1(3) of MiFIR (“Subject matter and scope”).

### **7.3 Creating a stand-alone suspension mechanism for the DTO**

87. EMIR Refit introduces a new mechanism to suspend the CO (Article 6a of the revised version of EMIR). As explained in Section 6 and supported by all respondents to the CP, ESMA suggests to mirror that possibility in MiFIR for the trading obligation, adapting the criteria to trigger such mechanism to the specificities of the DTO. ESMA stands ready to provide more technical advice in this respect should that solution be envisaged by the European Commission.

## **8 Annexes**

### **8.1 Annex 1 – Feedback to the consultation paper**

**Q 1: Do you have any comment on the analysis of the amendments in relation to financial counterparties?**

All respondents to the Consultation Paper agreed with the analysis on the impact on the MiFIR derivatives trading obligation of the changes introduced by EMIR Refit, for financial counterparties.

A few mentioned that in their view the current misaligned scope of counterparties was unintended.

**Q 2: Do you have any comment on the analysis of the amendments in relation to non-financial counterparties?**

All respondents to the Consultation Paper agreed with the analysis on the impact on the MiFIR derivatives trading obligation of the changes introduced by EMIR Refit, for non-financial counterparties.

**Q 3: What is your view on the possible development of on-venue trading for contracts not cleared with a CCP? What are the challenges for the trading venues? What are the challenges for the counterparties exempted from the CO and subject to the DTO?**

Few responses were provided to this question, and from those provided two contradicting ideas emerged:

— On one hand, some explained that the main obstacle to the development of on-venue trading for contracts which are not CCP-cleared is the pricing issue. According to those, trading venues have difficulties in pricing non-cleared transactions because such pricing

partly depends on collateral arrangements. The collateral arrangements for cleared contracts are uniform (leading to the same price irrespective of the counterparties to this contract, everything else being equal). For non-cleared derivatives, collateral arrangements depend on individual credit support annex and differ between market participants. While this argument was not mentioned by trading venues, one of them nonetheless acknowledges that it is more efficient to trade on-venue contract that are cleared, because of the standardisation of the clearing workflow.

- On the other hand, others argue that there is already a significant offer of non-cleared contracts on-venue and that the volumes of non-cleared contracts executed on MTF and OTF is material, both in the dealer-to-dealer and dealer-to-customer segment. Some clients decide to voluntarily trade on-venue even when not subject to the DTO, as they are able to benefit from additional transparency, have access to more liquidity providers. Features such as the electronic workflow and straight-through-processing (STP) have also been cited as determinant for certain counterparties to voluntarily trade on-venue.

In relation to the second part of the question, no strong evidence has been provided suggesting that the counterparties exempted from the CO and subject to the DTO would face unbearable challenges.

**Q 4: What is your view on the arguments exposed above, supporting the status quo i.e. a misalignment between the scope of counterparties subject to the CO and the DTO (G20 objectives, compliance with the DTO less burdensome than with the CO)? Can you identify other arguments?**

In the CP ESMA mentioned two main factors supporting the status-quo, i.e. a misalignment in the scope of counterparties subject to the CO and the DTO. First, aligning the scope of counterparties would lead to less counterparties being subject to the DTO, which could appear at odds with the G20 commitment to increase the level of standardized OTC derivative contracts traded on exchanges or electronic trading platforms. Second, compliance with the DTO is likely to be less burdensome than compliance with the CO, hence the costs for market participants would not necessarily create a barrier to on-venue trading.

There were split views in relation to the G20 argument:

- Most responses did not agree with this argument on the basis that the G20 objective is itself caveated to be only applicable “where appropriate”. In their view, the mere fact that a contract is not centrally cleared renders the applicable of the DTO for such contract “inappropriate”;
- A few nonetheless consider that reducing further the scope of counterparties subject to the DTO is contrary to the G20 objectives and to those of MiFID II/MiFIR in general i.e. increasing transparency and efficiency in price-formation, both of which are beneficial for investors. Some mention that in this respect the EU is already lagging when compared to other jurisdictions where the scope of the CO and DTO are broader.

Several respondents agreed that compliance with the DTO is less burdensome than compliance with the CO. Some mention this is evidenced by counterparties voluntarily deciding

to trade on-venue contracts which are not in the scope of the DTO, which they see as a natural evolution linked to technology (STP, electronic order book). While not disagreeing with it, some consider this argument not sustainable because in their view imposing the DTO leads to a de-facto clearing obligation (as developed in the part below on Q5).

An additional point was made in favour of not aligning the scope of counterparties subject to the clearing and trading obligation: one stakeholder considers that the calibration of the threshold which allows for the distinction between small and large financial counterparties is inappropriate and therefore it should be avoided to replicate this flawed mechanism in MiFIR.

**Q 5: What is your view on the arguments exposed above, supporting the alignment between the scope of counterparties subject to the CO and the DTO (initial policy intention, potential de-facto clearing obligation, limitation of operation burden)? Can you identify other arguments?**

In the CP, ESMA mentioned three main arguments supporting the alignment in the scope of counterparties subject to the CO and the DTO: (1) the policy intention before EMIR Refit, pointing to a strict alignment of scope; (2) the potential de-facto clearing obligation imposed on counterparties which have been exempted therefrom after Refit, and yet subject to the DTO; and (3) the general policy intention behind EMIR Refit to simplify certain provisions, and to adopt a more proportionate approach thereto by reducing the administrative and regulatory burden, which should also be valid in the application of MiFIR.

Those supportive of the alignment of the scope (that is the majority of respondents) equally supported all those arguments. They also mentioned additional reasons going in the same direction:

- Aligning the scope of counterparties for two requirements which are closely interconnected leads to greater legal consistency and a simplification of the legal framework which is perceived as complex enough;
- The split of liquidity on MTF/OTF between cleared and uncleared contracts is not a desirable outcome;
- On top of the administrative burden, FC- would face additional costs linked to passed through fees resulting from the provision of liquidity, the setting up of venue connectivity; and account mapping and rulebook reviews;
- The administrative burden would not only apply to FC- but also to the liquidity providers as they would need to build and maintain different control framework for trades subject to the CO and DTO;
- Imposing the DTO on small market players might even discourage them from transacting derivatives under the DTO for the purposes of risk management, leading to a potential increased risk level in the financial system.

The argumentation related to the administrative burden was however challenged by a few stakeholders: while not contesting that compliance with the DTO for FC- entails some costs for

them at individual level, this should be nuanced by the costs for the financial system as a whole of not having them under the scope of the DTO (persistence of counterparty credit risks for uncleared contracts, under collateralisation, lack of transparency, complex bilateral market structure, inappropriate risk management).

In the same vein, one trading venue experienced several cases of market participants which started trading on-venue and quickly realised its benefits in terms of pricing, liquidity and transparency; and progressively migrating increased portions of their activity to electronic, on-venue trading. Those early adopters have somehow overstepped the perception of high individual costs. Creating an exemption for FC- might actually discourage or slow-down what could have been a natural incentive towards central clearing and on-venue trading. In this respect, providing long phased-in periods for those counterparties might be a better tool than a blanket exemption.

Several stakeholders also disputed the reasoning developed in paragraphs 44 to 46 of the CP, according to which an exemption from the DTO, for counterparties exempted from the CO, should have a limited impact on the volumes traded on venues, while alleviating the burden for a large number of counterparties. In their view, such statement should be supported by a thorough impact assessment, and in particular:

- the analysis mentioned in the CP only refers to interest and credit derivatives (i.e. the classes now subject to the CO and DTO). In other asset classes such as equity derivatives, the impact of exempting FC- would be much more significant due to a wider diversity of investors in this asset class. This argument of course would only be valid in case equity derivatives become subject to the CO/DTO;
- the analysis mentioned in the CP is based on stock rather than flow data. This data suffers several flaws (e.g. it includes trades that were entered into before the entry into force of EMIR and MiFID II/MiFIR, it does not reflect the multilateral and netting compression activities that reduce the outstanding notional amounts) and does not allow for a proper understanding of the impact on trading venues' volumes.

**Q 6: What is your view on ESMA's proposal to suggest an alignment in the scope of counterparties between the clearing and trading obligations?**

Based on the various arguments developed in Q4 and Q5 above, a clear majority of respondents agreed with ESMA's proposal to suggest an alignment in the scope of counterparties between the clearing and trading obligations.

The arguments of the few who did not support the proposal have also been exposed in Q4 and Q5 above and relate in particular to the G20 commitment and possible miscalibration of the threshold for FC-.

A third category of responses could however be identified: those respondents did not express a strong view on whether the scopes should be aligned but suggested that such decision appears premature. In their view, a reasonable way forward would be to undertake a thorough impact assessment to determine the population of counterparties that would potentially be excluded, and examine their volume of activity in contracts subject to the CO / DTO versus not

subject to those obligations. Such analysis would allow for a precise calibration of the respective clearing thresholds. For example, if such analysis concludes that very small proportion of volumes are under the CO/DTO, the thresholds could be reviewed downwards, or vice-versa. Meanwhile, the ESMA [statement](#)<sup>7</sup> on MiFIR implementation (which was supported in many responses) could continue to apply.

Finally, one response suggested not to exempt FC- completely but instead to adjust the phase-in period and allow enough time for those counterparties to undertake the necessary implementation steps. This is based on the assumption that an exemption would create a hurdle for those counterparties to benefit from the advantages of on-venue trading e.g. automatization of trades and improved quality of execution.

#### Proposals that go beyond those suggested in the CP

Several stakeholders proposed to not only align the scope of the counterparties subject to the clearing and trading obligations, but to go one step further by making the CO a pre-condition for the DTO. They consider that the introduction of such condition would make sure that any future amendments to the scope of the CO under EMIR, both in terms of counterparties and contracts, would automatically be taken into account for the DTO.

#### Proposals outside the scope of the CP

The responses to the CP included a number of other proposals that are listed below:

- the DTO should be removed completely; the DTO should be removed for funds;
- the clearing threshold for FC should apply differently. Currently, an FC is subject to the CO for all asset classes if it exceeds any of the asset class specific clearing thresholds. The proposal is that the FC should not be subject to the CO if they exceed a class on which there is a no clearing obligation (e.g. FX derivatives).

Those proposals relate to Level 1 provisions which are outside the scope of this report and hence cannot be discussed in this context.

Finally, one response pointed to an ambiguity created by the date of application of the DTO for counterparties in Category 3 that are not FC- and hence which remain subject to the CO and DTO. Table 5 of the ESMA [Public Register](#) on the trading obligation currently states that such date of application is 21 June 2019 (as per the relevant Commission Delegated Regulation) while the ESMA statement of 12 June 2019 states that “for financial counterparties in Category 3 which are subject to the CO, the date of application of the DTO should be the same as the new date of application of the CO as amended by EMIR Refit. This date of application should hence be four months following the above-mentioned notification, rather than 21 June 2019.” ESMA will amend the Public Register to take this comment into account.

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<sup>7</sup> Public Statement “MiFIR implementation considerations regarding the trading obligation following the entry into force of EMIR Refit”, ESMA70-156-1436, 12 July 2019

**Q 7: What is your view on the necessity to introduce a standalone suspension of the DTO in MiFIR? If you consider it is appropriate, do you have views on how it should be framed?**

Several respondents argued that the suspension of the CO should automatically trigger the suspension of the DTO.

Most of them also supported the introduction of a stand-alone mechanism to suspend the DTO for the reasons expressed in the CP, i.e. the application of the DTO follows different criteria than the CO, and the RTS adoption would be too slow to appropriately cater for swift or unexpected market developments.

However, they consider that the conditions for such possibility to suspend the DTO should be clearly defined in the law (e.g. lack of liquidity, unavailability of trading platforms).

**Q 8: Have you identified other aspects of the DTO under MiFIR that should be aligned with amendments introduced by EMIR Refit? If so, please explain the amendments to MiFIR that could be introduced.**

Stakeholders have not identified other aspects of MiFIR that should be aligned with amendments introduced by EMIR Refit.

## 8.2 Annex 2 – Commission mandate

*Article 85(3a) of EMIR as amended by EMIR Refit:*

'3a. By 18 May 2020, ESMA shall submit a report to the Commission. That report shall assess:

(c) the alignment of the trading obligation for derivatives under Regulation (EU) No 600/2014 with changes made under Regulation (EU) 2019/834 to the clearing obligation for derivatives, in particular to the scope of the entities that are subject to the clearing obligation;