

**NON-DISCRIMINATORY ACCESS  
TO MARKET INFRASTRUCTURES AND BENCHMARKS  
(MiFIR Articles 28-30)**

### **Executive Summary**

**The European Commission (EC) proposals to give trading venues and central counterparties (CCPs) non-discriminatory access to one another and to benchmarks is critical to creating a competitive and safe single market in trading and post-trading services.** With the aim of ensuring optimum economic benefits and protections for investors, the EU has long sought a competitive and safe single market in trading and post-trading services. This Note explains why the delivery of that objective will depend critically on the EC proposals in MiFIR to give trading venues and CCPs fair access to one another and to benchmarks.

**The 2001 Giovannini Report identified the lack of competition between post trade service providers as the source of material costs to investors and a barrier to an integrated European financial market.** To increase competition in post-trade services, the industry signed the 2006 Code of Conduct on Clearing and Settlement. Progress was made in price transparency and service unbundling, but the Code failed to deliver the access between infrastructures required for competition. This failure is explained by the voluntary nature of the Code which allowed vested interests to prevail and by the absence of a level regulatory playing field. While the concerns regarding regulation have now been addressed by regulators in their examination of interoperability and by the EMIR legislation, the vested interests in the current uncompetitive environment can only be addressed through the legislation proposed by the EC.

**The proposal to give trading venues fair access to CCPs is critical to ensuring competition and mitigating risk at the trading level.** The EC proposes that venues be given the right to have trades executed on their platform, cleared at their CCP of choice. This right is critical to creating competition between venues because to offer a real alternative, a new entrant must offer its customers' combined trading and clearing costs comparable to those of the existing venue. While the new entrant sets its own trading costs, the costs of clearing will depend on whether customers can concentrate their clearing business which will in turn require the new entrant venue to access the existing CCP. We expect that the ensuing competition will reduce the cost and improve the quality of trading services, and help diversify the sources of liquidity.

**The proposal to give CCPs fair access to venues is critical to ensuring competition and mitigating risk at the clearing level.** MiFIR Article 29 proposes to give CCPs wishing to clear trades executed on a venue, a right of access to the trade feed of that venue. This right is critical to fostering competition between CCPs as it puts the new entrant CCP on a level playing field with the venue's existing CCP (providing the two CCPs interoperate). We anticipate that the ensuing competition will reduce the cost and improve the quality of clearing services. We further expect that exposing CCPs to competition will mitigate the risks of CCP monopolization.

**The proposal to give venues and CCPs fair access to benchmarks is critical to ensuring competition in the trading and clearing of derivatives based on those benchmarks.** The market in benchmark derivatives is dominated by a very small number of venues who each lists derivatives without allowing others to license the indices on which they are based. As a result, competition is stymied, keeping trading costs high and concentrating trading, clearing and risk. The EC proposal is essential to breaking that monopoly to foster innovation and cost reduction in the trading and clearing of benchmarks and to mitigate the concentration of risk.

**Note structure.** Based on an outline of the background for the EC proposals, this Note explains why these are critical to ensuring economic benefit for investors and to mitigating risk in trading and clearing. The Note also addresses concerns raised on the potential impact of the proposals on liquidity fragmentation and on the global competitiveness of market infrastructures.

## Background

**The basis for the Commission's proposals in MiFIR Articles 28-30 lies in the failure of the 2006 European Code of Conduct on Clearing and Settlement to deliver competition in the post-trade sector.**

The 2001 Giovannini Report<sup>1</sup> identified the fragmentation of the European clearing and settlement infrastructure as the source of material inefficiencies by inhibiting competition between national service providers. The Report states that the inefficiencies in the post trade processing of cross-border relative to domestic transactions is reflected in three types of additional costs to investors: (i) direct costs in the form of higher fees for the cross-border clearing and settlement services provided; (ii) indirect costs in the form of extra back-office facilities that must be maintained (often bought in from an intermediary) so as to manage the clearing and settlement of cross-border transactions; and (iii) opportunity costs in the form of inefficient use of collateral, a higher incidence of failed trades and trades that are simply foregone because of the difficulties involved in post-trade processing across borders. The Report concluded that inefficiencies in clearing and settlement represent the most important barrier to integrated financial markets in Europe.

Against this background, and with the aim of increasing competition in the post-trading sector, the industry signed the 2006 European Code of Conduct on Clearing and Settlement<sup>2</sup>. The measures detailed in the Code address three main issues: (i) transparency of prices and services; (ii) access and interoperability; and (iii) unbundling of services and accounting separation. While significant progress has been made in improving transparency and unbundling services, the Code has not delivered the access between infrastructures that is required for appropriate levels of competition in Europe's financial markets. For example, among EU regulated markets, only the London Stock Exchange has to date given access to its trade feed to a CCP outside of its own group, which together with interoperability between the CCPs, allows its customers a choice of where to clear their trades. The lack of progress is ascribed to the voluntary nature of the Code which allowed the vested interests of the infrastructures to prevail and to the absence of a level regulatory playing field across Europe.

Without legal obligation, the vested interests of infrastructures have in most instances prevailed. This has been most clearly evident in the case of infrastructure groups that include both trading and clearing platforms (sometimes referred to as 'vertical silos'). Given the potential loss of revenue, many such groups are inherently opposed to providing their trade feeds to would-be competitors to their 'in-house' CCP, and to providing would-be competitors to their trading platform with fair access to their CCP.

In terms of the regulatory playing field, infrastructures have repeatedly pointed to the absence of EU wide regulation of CCPs as a material obstacle to allowing infrastructures to access one another; the concern being that differences in regulation may create the potential for regulatory arbitrage and/or risk contagion between infrastructures. We consider that the legitimate concerns regarding the regulatory playing field have now been addressed by regulators in the course of their examination of CCP-interoperability and by the EMIR legislation.

Given the failure of the Code to change behavior, we believe that the commercial interests in favour of retaining the status quo and thus denying investors the benefits of a competitive trading and post-trading environment can only be addressed through the legislation proposed by the EC.

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<sup>1</sup> [http://ec.europa.eu/internal\\_market/financial-markets/docs/clearing/first\\_giovannini\\_report\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/clearing/first_giovannini_report_en.pdf)

<sup>2</sup> Link: [http://ec.europa.eu/internal\\_market/financial-markets/docs/code/code\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/code/code_en.pdf)

## **Non Discriminatory Access to a CCP (MiFIR Article 28)**

**The EC proposal to give trading venues non discriminatory access to CCPs is critical to ensuring choice and competition between trading venues and avoiding risk concentration in the trading of financial instruments.**

The EC proposes to give execution venues a conditional right to have their trades cleared at the CCP of their choice on a non-discriminatory basis. This right of access to CCPs will foster competition, increasing innovation and lowering costs at the trading level. To provide a competitive alternative to an existing trading venue (including its clearing arrangements), a new entrant venue must do more than just provide the ability to trade an in-demand security or derivative (see comment below re. Article 30), it must also offer its customers combined trading and clearing costs comparable to those of the existing venue.

While the costs of trading are determined by the new entrant venue, the costs of clearing will depend on the CCP to which access is sought; specifically whether in terms of access and price, trades executed on the new entrant venue are treated in non-discriminatory way in comparison with trades executed on the existing venue. The costs of clearing transactions in the same/similar instruments executed on different venues may be minimized to the extent that the CCP nets economically equivalent positions and cross-margins correlated contracts. An approximation of the potential savings can be gleaned from the Deutsche Borse and NYSE/Euronext estimate that investors could reduce annual collateral-posting by EUR 3 billion through the consolidation of clearing. This netting and cross-margining can be achieved through either the concentration of clearing in the CCP to which access is sought or through other arrangements, including interoperability (if applicable) between the CCP to which access is sought and the new entrant's CCP.

In the context of exchange-traded derivatives the need for a new entrant venue to have access to non-discriminatory clearing arrangements is illustrated by the following example: the contract between NYSE/Euronext LIFFE (derivatives venue) and LCH.Clearnet Ltd (derivatives CCP) does not allow customers of other venues access to the same central margin pool of LCH. Such access would otherwise have allowed customers to net their margin requirements between products traded on LIFFE and same/similar products traded on other platforms (e.g. the FTSE 100 contract is traded on both LIFFE and Turquoise). This denies potentially significant margin netting benefits to LIFFE customers who are also customers of other exchanges and thus limits competition at the trading level. Likewise, other vertical silos in Europe do not allow customers of other venues access to their margin pool (e.g. Deutsche Borse does not allow potentially competing venues to access its CCP, Eurex Clearing). The MiFID review and EMIR will in combination result in the transfer of a large number of standardised OTC derivatives products to the exchanges, under the so-called 'trading obligation'. It is critical that there is adequate opportunity for competition amongst those trading platforms that would be able to offer such services.

In addition, the proposed three month period within which the CCP must permit or deny the trading venue access should not be extended. A longer period of delay prior to notification is unreasonable from a competition perspective and cannot be justified on the grounds of necessity: a CCP should know – or should be required to determine - if a trading venue does not fulfil that CCP's access requirements (requirements which should be publicly available) within a reasonable timeframe.

## Non Discriminatory Access to Trading Venue (MiFIR Article 29)

**The EC proposal to give CCPs non discriminatory access to trading venues is critical to ensuring choice and competition between CCPs and to avoiding unnecessary risk concentration at the clearing level.**

The EC proposes to allow a CCP wishing to clear trades executed on a given trading venue, a right of non-discriminatory access to the trade feed of that venue. This right of access is essential to fostering competition, increasing innovation and lowering costs at the clearing level. To be able to clear trades executed on a given venue, a CCP must have access to the trade feed of that venue. The CCP is then able to compete with the venue's existing CCP providing it interoperates with the new-entrant CCP or other clearing arrangements are in place. Interoperability or other arrangements are needed to accommodate the reality that not all members of the new entrant CCP will also be members of the CCP of the venue to which access is sought.

Acknowledging that the risk of interoperability between CCPs clearing derivatives have not yet been fully explored, and the consequent limitation in EMIR of a CCP's *right* to interoperate with another CCP to the securities markets, we believe that MiFIR Article 29 will in the first instance only foster competition between CCP's servicing cash securities markets.

A very limited number of securities exchanges are currently - subject to conditions set by their supervisors - providing their trade feeds to more than one CCP. For example; in addition to its longstanding CCP (LCH.Clearnet), the London Stock Exchange provides trade feed access to its main market to one other CCP (SIX X-Clear) thus giving customers a choice of CCP. However, together with other European exchanges, the LSE has been reluctant to commit to further access by CCPs, citing regulatory uncertainty.

In contrast, Multilateral Trading Facilities have been more willing to provide their trade feeds to multiple (interoperating) CCPs allowing their customers a choice of CCP. Following a comprehensive exploration of the risks of interoperability, the Dutch, Swiss and UK supervisors recently agreed to permit four-way CCP interoperability on the cash equity market between EMCF, EuroCCP, LCH.Clearnet and SIX X-Clear. BATS/Chi-x and Turquoise have given the four CCPs access to their trade feeds allowing users have a clear choice of CCP. High volume users now pay costs that edge ever closer to the cost of clearing in US cash markets, whilst on the trading side large and small users can pay, on average, 90% less than the highest trading fees on the incumbent exchanges.

However, clearing costs will remain high where a new entrant CCP is denied access to a venue's trade feed as the venue's existing CCP is insulated from competition.. The ability for a user to choose a single CCP (requiring access to the trading venues on which the CCP user trades) would lead to economies of scale in unit pricing, the ability perform to cross-exchange netting and the optimization of risk netting by not splitting portfolios. By implementing the proposed Article 29, trading venues will be compelled to route trades to the CCP of the user's choice, rather than that of the venue's preference. The benefits of user consolidation of their clearing business in their CCP of choice will flow back to pension funds, investment managers, retail investors and companies by virtue of their respective clearing providers charging lower fees.

CCP competition will also mitigate the concentration of risk at a single CCP since we anticipate that CCP users are as a group unlikely to consolidate their clearing business at the *same* CCP.

A number of commentators have suggested that the proposed right of access to trade feeds will fragment trading liquidity, thus undermining the stability promoted by a single pool of liquidity during stressed situations. However, rather than an increase in risk, we consider that the opposite result would ensue through greater diversity in access to liquidity. We believe that

fewer, larger, highly concentrated sources of liquidity are likely only to increase systemic risk as market or liquidity conditions become more stressed. By exposing existing venues to competition, the EC proposal will help to diversify the sources of liquidity and thus mitigate the risks of liquidity concentration, especially during distressed market conditions. Not only would more avenues of access to liquidity mitigate systemic risk and stressed markets, it would fulfill one of the core objectives of MiFID, i.e., that venues should compete to provide better terms for users of those venues. Moreover, if fragmentation were to occur at the trading level, past trends suggest that a period of consolidation soon follows as competition - under the supervision of Competent Authorities - determines which infrastructures successfully serve market and end-user needs while fulfilling systemic functions appropriately (e.g., reducing systemic risk).

Other commentators have also referred to the heightened operational risks implied by a larger set of relationships between CCPs and venues, the risk of a race to the bottom on risk management where CCPs compete for business and greater difficulty for market supervisors in dealing with trading spread across multiple venues. We acknowledge these potential risks and submit that AFME Members' have every incentive to ensure that these are properly addressed given that it is our Members' and their clients' collateral at most risk should a CCP run into difficulties. Indeed, we consider that the risks identified will be appropriately addressed in the context of the supervisory approval of interoperability arrangements.

### **Non-Discriminatory Access to Benchmarks (Article 30)**

**The proposal to require entities with proprietary rights to a benchmark to license this to venues and CCPs on a non-discriminatory basis is critical to ensuring choice and competition in the trading and clearing of derivatives based on those benchmarks.**

The market in benchmarks (i.e. indices) is dominated by a handful of venues with little or no competition. Each lists benchmark derivatives without allowing other platforms to license the indices on which they are based. As a result, the existing benchmark derivatives do not compete with one another and the entry of new potentially competing products is effectively prevented. The existing products are based on different indices and are not substitutable as they offer different exposures. The underlying indices are usually protected by IP rights and cannot be freely used. For example, Deutsche Borse has proved unwilling to grant index licenses (e.g. on the DB EURO STOXX 50) to its competitors to enable them to establish competing products on competing platforms. Given the overriding preference of market participants to only trade established index products as well as the practical difficulties of replicating an existing index (the calculation of an index includes certain elements, such as the treatment of certain corporate actions, the handling of which is partly at the discretion of the index provider), the creation of a new benchmark as a competitive alternative is not a viable option.

Accordingly, trading costs are kept artificially high. Pension funds, investment managers and even issuers are impacted by this lack of competition. Policy makers should therefore consider whether owners of current benchmarks are enforcing monopolistic behaviour through intellectual property that may have little or no inherent innovative value. In such cases, one should favour the right to achieve competition despite intellectual property rights, especially of copyright-like intellectual property that may have little inherent novelty, if those rights are used only as a tool to enforce monopolistic behaviour thus creating private rewards that bear no relationship to the innovation's incremental value.

We support the EC proposal to require entities with proprietary rights to a given benchmark to license this on a non-discriminatory basis. This will together with the access of venues to CCPs (see above comments regarding Article 28) foster competition and innovation in benchmark derivatives and mitigate monopolistic concentration.

## **European Competitiveness**

AFME understands that some have expressed a concern that other G20 members are not implementing equivalent non discriminatory (open access) requirements, suggesting that Europe's infrastructures would be put at a disadvantage. We anticipate a different marketplace where greater competition among venues will lead to better services and lower transaction costs, which will make European infrastructures more attractive to all users. The real economy would benefit from increased cross-border liquidity and market efficiencies e.g., significant savings in collateral management, thus facilitating the raising of capital by issuers at lower implied costs. From a wider perspective, increased access also prevents new risks from being concentrated with potentially cataclysmic results in fewer, larger too-big-to-fail infrastructure providers

## **Conclusion**

The EU has, in the context of ensuring optimum economic benefits and protections for European investors, long sought a competitive and safe single market in trading and post-trading services. Central to achieving that objective was the EU Code of Conduct on Clearing and Settlement. European market infrastructures were presented with a choice in 2006. They could comply with a voluntary Code of Conduct, designed to give consumers greater choice and promote competition, or prepare to be regulated. With a few exceptions, verbal support for the Code has not translated into action.

The proposed provisions are critical to ensuring competition and avoiding risk concentration in the trading and clearing of securities and derivatives. By providing access to the incumbent exchanges' clearing arrangements, the proposed Article 28 will help enable new entrant trading venues compete with the incumbent exchanges. In doing so, the Article will encourage innovation, cost reduction and risk diversification at the trading layer. By providing access to the incumbent exchanges' trade feeds, the proposed Article 29 will help enable new entrant CCPs compete with the CCP already used by the incumbent exchange. In doing so, the Article will encourage innovation, cost reduction and risk diversification at the CCP-clearing layer. By providing access to benchmark indices, the proposed Article 30 will help enable competition in the trading and clearing of derivatives based on those indices. In doing so, the Article will encourage innovation, cost reduction and risk diversification at both the trading and clearing level.

The failure of the Code of Conduct to deliver meaningful competition and risk diversification can be ascribed to a combination of regulatory uncertainty and to vested commercial interests. The legitimate concerns regarding the regulatory playing field have now been addressed by regulators in the course of their examination of CCP-interoperability and by the EMIR legislation. We believe that the commercial interests, in favour of retaining the status quo and thus denying investors the benefits of a competitive trading and post-trading environment, can only be addressed through the legislation proposed by the EC.