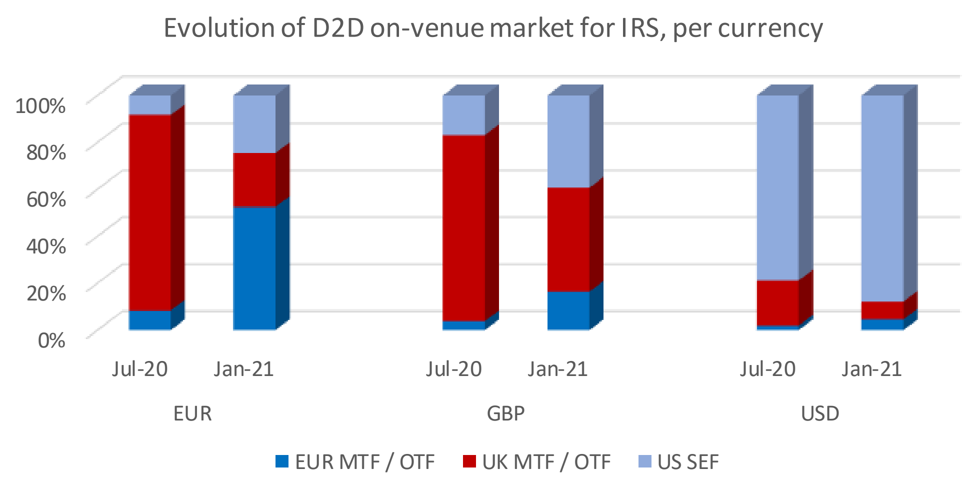
8 March 2021

While flows to EU venues have increased post-Brexit, the market share and competitiveness of EU intermediaries strongly suffer from the conflicting applications of EU and UK DTOs

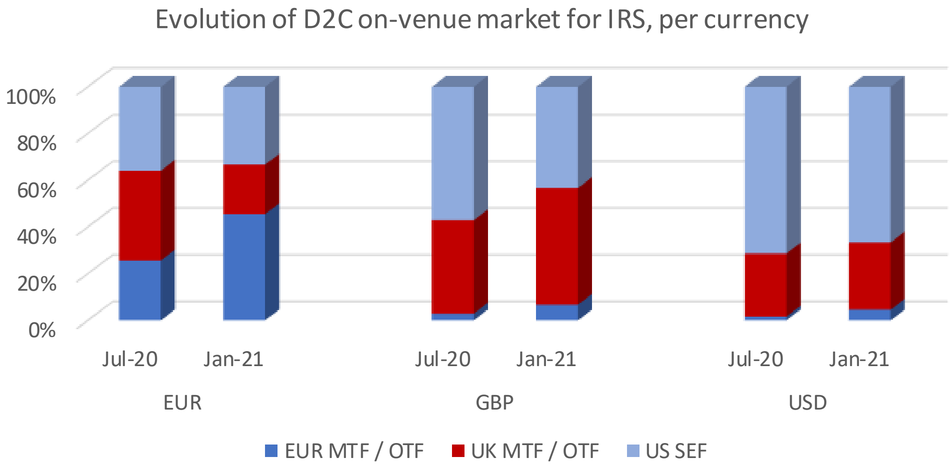
Dear Mr Berrigan,

The undersigned associations[1] wanted to follow up to the letter sent to you on 21 December 2020[2] in order to highlight the detrimental implications that the overlapping application of EU and UK derivative trading obligations (DTO) have had on liquidity since Brexit and therefore reiterate the urgent need for the European Commission to find a regulatory solution even temporary.

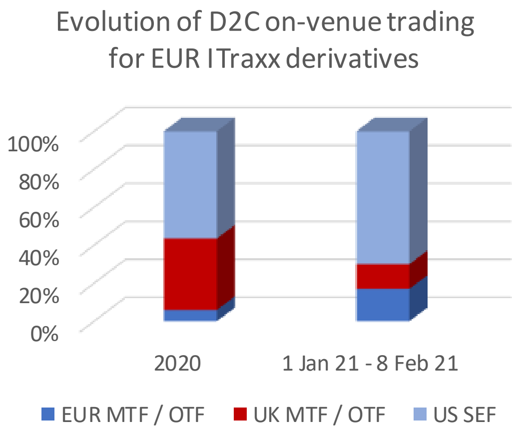
Since 1 January 2021, the uncoordinated application of EU and UK DTOs has led to significant upheavals in the liquidity of instruments subject to the trading obligations, both in the interdealer (D2D) and in the dealer-to-clients (D2C) markets, overall reducing the global competitiveness of EU-27 financial institutions. Based on data recently issued by IHS Markit[3], our view on the evolution of on-venue liquidity for **IRS** between mid-2020 and January 2021 is as follows:



[1] More information about each association is available in Appendix.
[2] Letter on *the detrimental impact of the conflicting application of EU and UK derivative obligations on EU capital markets,* link
[3] Link to IHS Markit publication.



For EUR ITraxx credit derivatives, we did not see any similar study to the one conducted by IHS Markit for IRS. Still, based on data consolidated from the main D2C platforms, and on feedbacks from the most active D2D brokers, our view on the evolution of on-venue liquidity between 2020 and the first weeks of 2021 is as follows:



On the D2D side, while UK OTFs used to concentrate virtually all the flows, they lost ground to the benefit of US SEFs, and now represent 2/3 of the market. It should be noted that EU venues are not operational to date.

At first sight, the evolution of on-venue liquidity for IRS and CDS instruments could be interpreted as a real success for the Union, as EU-27 platforms have significantly increased their market share for on-venue trading of EUR-denominated IRS (from 8% to 52% for D2D flow and from 26% to 45% for D2C flow), even though they remain marginal players on GBP and USD IRS and have tripled their market share on D2C EUR ITraxx activity (from 6% to 17%).

Still, a more in-depth analysis leads to different, far less favourable, conclusions when it comes to the competitiveness and market share of EU intermediaries which have strongly suffered as a result of the conflicted application of EU and UK DTOs.

First, the significant market shares retained by UK platforms in the D2C area (with an increase for GBP IRS products) highlight the depth of the client franchise that EU-27 financial institutions have lost access to. As probably revealed by the answers to the questionnaire that your services sent early January to EU institutions that address the UK market through branches, their market share has started to shrink, especially on GBP IRS instruments. This loss of access to UK clients and to non-EU non-UK clients to some extent – that are particularly important for derivative instruments – **is a major concern as the drop in volumes that it entails puts medium to long-term competitiveness of EU-27 financial institutions under direct threat**, especially their ability to provide the best services at the lowest cost to address the needs of EU-27 companies and investors. This is all the more problematic as UK entities do not seem to be willing to distinguish between DTO and non-DTO instruments when electing their potential counterparties.

Besides, while the market share of UK venues has decreased in most segments, it remains nevertheless important, especially when one considers the various pockets of liquidity to which EU entities have lost access to since 1 January. So far, while EU-27 entities' access to D2D liquidity has remained sufficient to manage their risks, their inability to access nearly 25% of D2D on-venue liquidity for EUR IRS, 44% of that liquidity for GBP IRS instruments, close to 10% for USD ones and almost 70% of that liquidity for ITraxx CDS **is a major concern as the loss of volumes that it entails puts their medium to long-term competitiveness under direct threat.** Indeed, limited access to D2C and even more to D2D flows means that EU institutions face higher hedging costs compared to their international competitors, with a direct impact on the prices they can offer to clients.

Accordingly, unless a regulatory measure is taken shortly by the European Commission, we anticipate that the US SEFs would be the ultimate beneficiaries of the current overhaul of on-venue liquidity as we expect the high volumes of liquidity already transferred to attract even more in the medium to long term. Especially as firms are still finalizing their set up post COVID 19 but also given the FCA statement relief which only applies temporarily and allows London based traders to trade with EU clients on EU trading venues. Such outcome would not only severely and durably damage the global competitiveness of EU institutions in the derivative market, but it would also go against the Union's ambition to increase its sovereignty and the competitiveness of its financial markets through the deepening of the Capital Markets Union initiative. Inter alia, the market share gained by US venues means that a growing part of EUR trading will be subject to US rules, and that part of the clearing of transactions could also move to US infrastructures, jeopardising the intended relocation of clearing of EUR derivatives to Union based CCPs[4].

In this context, we call again on the European Commission to work on a temporary solution in the short term which would be different from granting equivalence as we understand it would have broader political implications. We would therefore recommend targeted measures to prevent the scopes of the EU and the UK DTOs to overlap. In particular we would favour a temporary forbearance of the EU DTO applicable to UK branches of EU-27 financial institutions for their derivatives activities with non-EU clients for a period of at least 12 months.

We remain at your disposal to further elaborate on this issue and other potential options that you might consider as a way forward.

Sincerely,

[4] As highlighted by the European Commission in its Communication: *The European economic and financial system: fostering openness, strength and resilience,* p. 13, link

Stéphane GIORDANO
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Director General Delegate
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<u>To the attention of</u>:

Mr John BERRIGAN
Director General
DG FISMA
European Commission

Appendix – Information about signatory organisations

The Association française des marchés financiers (AMAFI) is the trade organisation working at national, European and international levels to represent financial market participants in France. AMAFI has more than 150 members operating for their own account or for clients in equities, fixed-income, structured products and derivatives. Nearly one-third of its members are subsidiaries or branches of non-French institutions. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located.

The Italian Financial Markets Intermediaries Association (Associazione Intermediari Mercati Finanziari – ASSOSIM) represents the interests of the intermediaries active on the Italian financial markets, namely, Italian investment firms, investment banks and subsidiaries of foreign investment services providers. Its members account for nearly the entire amount of the transactions carried out on the Italian stock markets as from Italy, and more than 80% when considering cross border transactions.

The Banking and Payments Federation Ireland (BPFI) is the principal voice and representative body of the banking, payments and fintech sectors in Ireland, with offices in Dublin, Brussels and Frankfurt. Together with its affiliates the Federation of International Banks in Ireland (FIBI) and the Fintech & Payments Association of Ireland (FPAI), BPFI represents over 100 financial institutions operating in Ireland. Specifically, BPFI membership includes domestic banks offering retail financial services to clients and customers across Ireland, international banks engaged in capital markets and corporate banking services. It also includes fintech and payments institutions with propositions spanning a wide range of product areas including payments, regtech, distributed ledger technology and cyber-security among others.

The Bundesverband Deutscher Banken (BDB) is the voice of the private banks in Germany. As a leading trade association, it coordinates, shapes and represents the interests of the private banking industry and acts as a mediator. The BdB represents more than 170 private commercial banks, 30 associated members as FinTechs and eleven member associations. The private commercial banks affiliated to the association compete keenly with one another. They include both big and small banks, banks operating worldwide and banks with a regional focus, universal banks and banks specialising in individual lines of business.

The Fédération bancaire française (FBF) has for mission to promote the banking and financial industry in France, Europe and around the world. It determines the profession's positions and makes proposals to public authorities and economic/financial authorities. FBF has 340 member banks including 115 foreign banks. Regardless of their size and status, credit institutions licensed as banks and the branch offices of credit institutions in the European Economic Area can, if they wish, become fully-fledged members of the FBF. The central bodies of cooperative or mutual banking groups are also fully-fledged members. The FBF is member of the European Banking Federation (EBF).