

01st June 2016

Tom Springbett, Manager, OTC Derivatives and Post-Trade Policy
Anne-Laure Condat, Senior Associate,
Carmel Deenmamode, Associate,

Derivatives Reform, Markets Infrastructure and Policy, Markets Division
Financial Conduct Authority
25 The North Colonnade, Canary Wharf, London E14 5HS

cc. Stephen Hanks, Roger Pordes

Dear Tom, Anne-Laure, and Carmel,

Clarification on Venue Obligations under RTS 26

In accelerating our joint preparation for overall MiFID II implementation, the 'WMBA'¹ seeks guidance on a particular element of RTS 26. Specifically, this letter highlights Article 2 of draft RTS 26 referring to, '*Pre-trade credit checks for cleared derivatives executed on a trading venue,*' where orders presented to a MTF or OTF are subject to pre-trade credit checking unless points (a), (b) and (c) of 2.1 are met².

Recently WMBA member firms have approached the FCA with specific 'use case' enquiries which have served to substantively clarify forward planning for the implementation of MiFIR. As communicated back to venues by your colleagues in supervision, these have added colour to very specific areas of policy and rule-making and has been considered beneficial within the Authority.

The WMBA wish to make two comments in respect of the CCP Clearing of derivatives under MiFID:

i. Locus of Trade Allege and of Execution

RTS 26 2.1(b) references that the rules of the CCP should provide for the executed transaction to be cleared automatically and immediately, with the clearing member becoming the

¹ The Wholesale Markets Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) (jointly referred to in this document as the 'WMBA') are the European industry associations for the wholesale intermediation of platform and Over-the-Counter (OTC) markets in financial, energy, commodity and emission markets and their traded derivatives. Our members act solely as intermediaries in wholesale financial markets and do not undertake any proprietary trading. As a result, they are classified as Limited Activity and Limited Licence Firms in respect of the current Financial Conduct Authority classification.

² (a) the rules of the trading venue require that each member or participant of the trading venue, which is not a clearing member of a CCP through which the cleared derivative transaction is cleared, has a contractual arrangement with a clearing member of the CCP under which the clearing member automatically becomes counterparty to the cleared derivative transaction;

(b) the rules of the CCP provide that the cleared derivative transaction executed on a trading venue is cleared automatically and immediately, with the clearing member referred to in point (a) becoming the counterparty to the CCP;

(c) the rules of the trading venue provide that the member or participant of the trading venue or its client becomes counterparty to the cleared derivative transaction, pursuant to direct or indirect clearing arrangements.

counterparty to the CCP. Correspondingly, WMBA draws your attention to current market infrastructure and processes that connect venues and CCPs.

Currently, in the majority of cases across the breadth of asset classes, at point of execution a venue will '*allege*' a transaction to the two counterparties, typically via a piece of third party middleware. This allege will be affirmed either electronically or manually by both counterparties whereupon a notice of execution is then issued, the trade is legally confirmed, and only then submitted to the CCP for novation. In this way, it is normal and standard market convention that the venue is not the vehicle by which trades are submitted to CCPs by the counterparties (the customers to the trading venue). Moreover, there is frequent 'post-allege' message information and transformation that requires counterparty input, including any amendments.

With that in mind, WMBA members determine that the term, '*automatically and immediately*' refers specifically to post-arrangement processes at the CCP where matching and novation actually occur following the affirmation of the trade by both counterparties. For the avoidance of doubt, as the clearing takes place distinctly and separately from the venue, the venue may meet the condition expressed in 2.1(b) by delivering the arranged transaction to the CCP in accordance with the rules of that CCP.

ii. Global Precedence for the Checking of Client Credit

There is no precedent globally for venues being responsible for checking credit of client orders. In fact CFTC rules concerning SEF venue obligations have a diametrically opposed structure where a client who is a 'self-clearer' or a client's clearer (in US parlance 'FCM' (Futures Commission Merchant)) jointly bear 100% of the obligation to pre-check orders when applicable. Clearly any such responsibility would serve to greatly further fragment liquidity and defeat the competition and choice objectives at the heart of original MiFID.

Under Dodd-Frank CEA, these rules are set forth in (a) CFTC Rule 17 CFR 1.73³ (effective October 2012) as a pre-condition for FCM risk management practices involving third parties and (b) CFTC Rule 17 CFR 23.609⁴ pertaining to Swap Dealers (SDs) who are not FCMs, SEFs and DCOs (also effective October 2012) where SDs are mandated to have practices in place to anticipate and capture their own risk.

The CFTC's notable, '*STP Guidance Letter*⁵' dated 26 September 2013 refers only to SEFs responsibilities under 37.702 to '*facilitate prompt and efficient processing by DCOs*,' and that '*no trade intended for clearing may be executed on or subject to the rules of the SEF unless a clearing member has identified in advance for each party on an order-by-order basis*.'

Therefore as there is no specific rule obligating SEFs (soon to be the equivalent venue to MTFs and OTFs) to pre-check credit of orders coming from self-clearing SDs, any potential need for MTFs and OTFs to perform this function will not be synchronous and in deference with all

³ <http://www.cftc.gov/ide/groups/public/@newsroom/documents/file/federalregister032012.pdf>

⁴ <http://www.cftc.gov/ide/groups/public/@newsroom/documents/file/federalregister032012.pdf>

⁵ <http://www.cftc.gov/ide/groups/public/@newsroom/documents/file/stpguidance.pdf>

other global marketplaces and thus may result in orders being sent outside the EU once execution equivalence is achieved.

We additional underline that clarifying the boundaries of venue obligations relative to those of post trade FMIs, particularly of CCPs, is all the more important given the impending 1st September 2016 application of bilateral initial margin on uncleared trades which may additionally fragment liquidity around those counterparties adhering to certain protocols such as ISDA_SIMM⁶ and will strongly influence the voluntary use of CCPs generally going forward.

WMBA would be pleased to discuss this further on a call or in person at your earliest convenience, and as ever WMBA remains at your disposal for further conversations.

Best Regards,



Alex McDonald

CEO, WMBA

⁶ <http://www2.isda.org/functional-areas/wgmr-implementation/>
[http://www2.isda.org/attachment/ODM1Mw==/ISDA%20SIMM%20Methodology_7%20April%202016_v3.15%20\(PUBLIC\).pdf](http://www2.isda.org/attachment/ODM1Mw==/ISDA%20SIMM%20Methodology_7%20April%202016_v3.15%20(PUBLIC).pdf)