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European Commission
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Ref: MiFID II / MiFIR third country regime, placing of trading screens in the EU and lack of temporary suspension regime for the trading obligation for derivatives

Dear Vice-President Dombrovskis,

I am writing to you regarding some issues which ESMA has recently identified in MiFID II/MiFIR in the context of its work on the UK's withdrawal from the European Union (EU). I would like to highlight in particular three items that should in our view be addressed in a timely manner: (i) the MiFID II / MiFIR's third country regime and the concerns it raises in particular with respect to firms dealing on own account; (ii) the lack of an EU-wide regime for third country trading venues accessing the EU market and placing trading screens; and (iii) the lack of a suspension regime for the trading obligation for derivatives. While those issues were identified in the context of the UK's withdrawal, ESMA believes that they are likely to have implications going beyond the withdrawal, thereby making it even more important to address them promptly.

Concerns regarding the MiFID II / MiFIR third country regime

ESMA has received several requests in recent months from market stakeholders as well as National Competent Authorities regarding the rules applicable to third country firms, and to which extent those firms should be authorised and supervised in the Union.

MiFID I does not specifically provide a third country regime and third country firms are, under the current legislative framework, subject only to the national rules applicable in the Member State where they undertake an investment service or activity. MiFID II does establish some common rules with respect to the provision of investment services or activities in the EU by third country firms, but it falls short of achieving full harmonisation.

In particular, we would like to draw your attention to the following aspects of MiFID II / MiFIR which have emerged following our preparatory work for implementation:

- there are still many circumstances where third country firms will not be subject to the provisions of MiFID II / MiFIR, but only to the national regimes in place creating a fragmented regulatory environment for third countries which raises concerns in the perspective of the UK's withdrawal from the EU;
- this fragmented environment is further exacerbated by the lack of clarity on certain provisions of the MiFID II / MiFIR third country regime and the extent to which those are applicable to the provision of certain investment services in the Union and, more specifically, to non-EU firms which are dealing on own account as high-frequency traders, through direct electronic access, as a member or participant of a trading venue, or as a market maker; and
- in the case where Member States decide to make use of the option to require non-EU firms to establish branches (Article 39 of MiFID II), it appears that those branches might be subject to less stringent requirements compared to EU investment firms (e.g. it appears that they would not be subject to the trading obligation for derivatives).

More importantly, our analysis of the MiFID II / MiFIR third country regime indicates that there might be circumstances where firms located in the EU would be subject to more stringent requirements than firms located outside the EU. This calls into question the effectiveness of the MiFID II / MiFIR regime regarding third countries since it remains possible for third country entities to provide investment services and perform investment activities in the EU without being subject to the new regime to be applied as of 3 January 2018. For these reasons, ESMA considers that this deserves particular attention, also considering the United Kingdom's withdrawal from the EU and the uncertainty on the regime applicable thereafter, thus making third country issues even more prominent in the near future.

We therefore encourage the European Commission to consider carefully the issues at stake and where appropriate, propose relevant amendments of the MiFID II / MiFIR third country regime to address them. More specifically, ESMA recommends that the European Commission reflects on the following possible actions:

- to reassess whether the MiFID II / MiFIR third country regime allows for an effective application of the MiFID II / MiFIR rules and achieves the objectives pursued with respect to activities such as high frequency trading and market making provided by third country firms; and
- to consider whether further integration and harmonisation regarding the rules applicable to third country firms should be introduced in order to avoid regulatory and supervisory arbitrage between jurisdictions both inside and outside the EU.

ESMA is reviewing some other elements of the third country regime and might propose specific actions to the European Commission in this respect. Irrespective of any such proposal, ESMA stands ready to provide advice to tackle any issues arising from the application of the third

country regime, should the European Commission consider that actions in this respect should be taken.

Third-country trading venues and the placing of trading screens in the EU

MiFID II creates specific equivalence regimes for third country venues trading in shares and derivatives subject to the respective trading obligations. It also addresses remote access to EU regulated markets by EU firms. However, the conditions under which third-country venues may access EU financial markets through the placing of trading screens in one or more EU Member State(s) are not harmonised at EU level. Through such trading screens, third-country trading venues may offer EU remote members direct access to the third-country venue's trading engine, under their own trading code, as any other full member or participant of that third-country venue.

In the course of its work on the "Opinion to support supervisory convergence in the area of secondary markets in the context of the UK withdrawing from the European Union", ESMA noted the diversity of rules across Member States governing the placing of third-country trading screens. Those rules can in some cases be very detailed while about half of the Member States do not have any such rules at all.

To ensure a consistent approach and support regulatory convergence across the EU, ESMA would recommend the introduction of a harmonised EU framework governing the placing of trading screens by third-country venues. ESMA considers that establishing such a harmonised EU framework would require an amendment of MiFID II.

Lack of a temporary suspension regime for the trading obligation for derivatives

ESMA fully supports the European Commission's proposal to introduce the possibility for temporarily suspending the clearing obligation under EMIR subject to certain conditions. Moreover, ESMA believes that a similar mechanism should be introduced for suspension of the trading obligation for derivatives under MiFIR. Currently, the only possibility for suspending the trading obligation for derivatives provided in MiFIR consists in ESMA amending its regulatory technical standards. However, ESMA considers that this approach does not allow reacting to rapid changes in the market environment such as a significant drop of liquidity. ESMA therefore recommends to amend MiFIR during the negotiations with the co-legislators on the proposed amendment of EMIR by introducing a similar temporary suspension regime for the trading obligation for derivatives. Such a mechanism might also become useful in the context of the UK's withdrawal to ensure a smooth transition in the case where certain derivative classes subject to the MiFIR trading obligation would not be suitable for such obligation any longer.

ESMA stands ready to discuss with you in more details the content of this letter and to advice the European Commission on any proposal resulting from the points raised.



Sincerely,

Steven Maijor

cc.: Roberto Gualtieri MEP, Chair of the Committee on Economic and Monetary Affairs,
European Parliament

Toomas Tõniste, President of the ECOFIN Council, Council of the European Union

Jeppe Tranholm-Mikkelsen, Secretary-General of the Council of the European Union

Olivier Guersent, Director General, DG Financial Stability, Financial Services and
Capital Markets Union, European Commission