esma European Securities and Markets Authority

Opinion (Annex)

Amended draft Regulatory Technical Standards on criteria for establishing when an activity is to be considered to be ancillary to the main business

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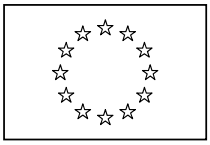
RTS 20: Draft regulatory technical standards on criteria for establishing when an activity is to be considered to be ancillary to the main business



EUROPEAN COMMISSION

Brussels, XXX
[…](2012) XXX draft

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supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for criteria to establish when an activity is considered to be ancillary to the main business

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments[1], and in particular Article 2(4) thereof,

Whereas:

(1) The assessment whether persons are dealing on own account or are providing investment services in commodity derivatives, emission allowances and derivatives thereof in the Union as an activity ancillary to their main business should be performed at a group level. In line with Article 2(11) of Directive 2013/34/EU of the European Parliament and of the Council[2], a group is considered to comprise the parent undertaking and all its subsidiary undertakings and includes entities domiciled in the Union and in third countries regardless of whether the group is headquartered inside or outside the Union.

(2) The assessment should be performed in the form of two tests, which are both based on the trading activity of the persons within the group and should be calculated on a per-asset-class basis. The first test should determine whether the persons within the group are large participants relative to the size of the financial market in that asset class and as a consequence should be required to obtain authorisation as an investment firm. The second test should determine whether the persons within the group trade on own account or provide investment services in commodity derivatives, emission allowances or derivatives thereof to such a large extent relative to the main business of the group that those activities cannot be considered to be ancillary at group level and that therefore the persons should be required to obtain authorisation as an investment firm. Where persons within the group operate simultaneously in different asset classes and exceed the threshold in relation to one asset class, it should be subject to Directive 2014/65/EU for all commodity classes.

[1] OJ L 173, 12.06.2014, p. 349.

[2] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (OJ L 182, 29.6.2013, p. 19).

(3) The first test compares the level of a person's trading activity against the overall trading activity in the Union on an asset class basis to determine the person's market share. The size of the trading activity should be determined by deducting the sum of the volume of the transactions referred to in points (a), (b) and (c) of the fifth subparagraph of Article 2(4), fifth subparagraph ('privileged transactions') from the volume of the overall trading activity undertaken by the group.

(4) The volume of the trading activity should be determined by the gross notional value of contracts in commodity derivatives, emission allowances and derivatives thereof on the basis of a rolling annual average of the preceding three calendar years. The overall market size should be determined on the basis of trading activity undertaken in the Union in relation to each asset class: metals, oil, coal, emission allowances and derivatives thereof, gas, power, agricultural products and other commodities. Trading activity comprises trading in contracts traded outside trading venues to which a person that is located in a Member State is party and contracts that are traded on trading venues located in a Member State.

(5) As commodity markets differ significantly in terms of size, number of market participants, level of liquidity and other characteristics, different thresholds shall apply for different asset classes in relation to the test on the size of the trading activity.

(6) The second test assesses the size of the trading activity, excluding privileged transactions and transactions executed by authorised entities of the group, undertaken by the group in all asset classes (the numerator) against the size of the overall trading activity, including privileged transactions and transactions executed by authorised entities of the group, undertaken by the group in total for all asset classes (the denominator).

(7) The size of the trading activity as used in the second test, including privileged transactions and transactions executed by authorised entities, is taken as a proxy for the commercial activity that the person or group does as its main business. This proxy should be easy and cost efficient for persons to apply as it builds on data already required to be collected for the first test while at the same time establishing a meaningful test.

(8) A rational risk-averse entity, such as a producer, processor or consumer of commodities, will seek to hedge the volume of the commercial activity of its main business with an equivalent volume of commodity derivatives, emission allowances or derivatives thereof. Therefore the volume of turnover of commodity derivatives measured in the gross notional value of the underlying, which are purchased or sold is an appropriate proxy for the size of the main business of the group. Main business of the group that is not related to commodities would not use commodity derivatives as a risk-reducing tool and therefore any co-existing trading in commodity derivatives would ab initio be speculative and unable to benefit from the ancillary exemption.

(9) The second test may inadvertently capture persons with a high proportion of trading which is neither privileged transactions nor executed in an authorised entity of the group but nevertheless have a very low level of trading activity in total. ~~IN~~ In addition, hedging activity cannot be considered a perfect proxy for the commercial activity that the person or group conducts as its main business as it does not take into account other investments of commodity market participants in fixed assets unrelated to derivative markets. Therefore, the second test should not solely operate on the basis of the application of this proxy but rather should contain a backstop mechanism which recognises that the trading activity undertaken by the persons within the group should also exceed a certain percentage of any of the thresholds set under the first test for each relevant asset class to be deemed non-ancillary. The higher the percentage of the speculative activity within all trading activity, the lower this threshold. Calibrating the main business test in this way should ensure that only relevant and sizable participants in European commodity derivative markets should be determined as not conducting their activities as ancillary to their main business.

(10) The rationale of the ancillary activity tests is to check whether entities not subject to financial regulation should be required to acquire an authorisation due to the relative or absolute size of their activity in commodity derivatives, emission allowances and derivatives thereof The ancillary activity tests determine the size of activities in commodity derivatives, emission allowances and derivatives thereof which entities within a group may carry out without authorisation under Directive 2014/65/EU due to those activities being ancillary to the group's main business. The group level assessment means that it is appropriate to calculate the size of the ancillary activity of the group by using criteria which exclude certain privileged transactions and activity carried out by authorised group members. This is because these transactions serve regulatory or commercial purposes or are otherwise already subject to appropriate supervision. Without excluding the activity of authorised group members, the exemption could have the effect of requiring the consolidation of genuine ancillary activity carried out by unauthorised group members, for example, persons which only execute privileged transactions, into the trading activity of its authorised members solely as a result of the size of the supervised trading activity of those authorised members. Trading activity undertaken by an authorised entity of the group should therefore be excluded from the calculations of the ancillary activity undertaken by unauthorised members of the group as it is already appropriately authorised.

(11) In order to allow for market participants to plan and operate a business in a reasonable way and to take into account seasonal patterns of activity, the calculation of the tests determining when an activity is considered to be ancillary to the main business should be based on a period of three years. Therefore, entities should perform the assessment whether they breach one of the two thresholds on an annual basis by calculating a simple average of three years on a rolling basis in order to be able to submit their annual notification to the competent authority. This obligation should be without prejudice to the right of the competent authority to request at any time a report from a person about the basis on which that person considers its activity under points (i) and (ii) under point (j) of Article 2(4) of Directive 2014/65/EU to be ancillary to its main business.

(12) Transactions objectively measurable as reducing risks directly relating to commercial activity or treasury financing activity and intra-group transactions should be considered in a way consistent with Regulation (EU) No. 648/2012 of the European Parliament and of the Council[3]. However, in relation to transactions in derivatives which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity Commission Delegated Regulation (EU) No 149/2013[4] only refers to derivatives not traded on regulated markets while Article 2(4) of Directive 2014/65/EU covers derivatives traded on trading venues. Therefore, this Regulation should also take into account derivatives traded on regulated markets in relation to transactions that are deemed to be objectively measurable as reducing risks directly related to commercial or treasury financing activity.

(13) In some circumstances, it may not be possible to hedge a commercial risk by using a directly related commodity derivative contract: a contract with exactly the same underlying and settlement date as the risk being covered. In such case, the person may use proxy hedging through a closely correlated instrument to cover its exposure such as an instrument with a different but very close underlying in terms of economic behaviour. Additionally, macro or portfolio hedging may be used by persons, which enter into commodity derivative contracts to hedge a risk in relation to their overall risks or the overall risks of the group. Those macro, portfolio or proxy hedging commodity derivative contracts may constitute hedging for the purpose of this Regulation.

(14) When a person applying the ancillary activity test uses portfolio or macro hedging, it may not be able to establish a one-to-one link between a specific transaction in a commodity derivative and a specific risk directly related to the commercial and treasury financing activities entered into to hedge it. The risks directly related to the commercial and treasury financing activities may be of a complex nature e.g. several geographic markets, several products, time horizons or entities. The portfolio of commodity derivative contracts entered into to mitigate those risks may derive from complex risk management systems. In such cases the risk management systems should prevent non-hedging transactions from being categorised as hedging and provide for a sufficiently disaggregate view of the hedging portfolio so that speculative components are identified and counted towards the thresholds. Positions should not qualify as reducing risks related to commercial activity solely on the grounds that they form part of a risk-reducing portfolio on an overall basis.

(15) A risk may evolve over time and, in order to adapt to the evolution of the risk, commodity derivatives initially executed for reducing risk related to commercial activity, may have to be offset through the use of additional commodity derivative

[3] 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 (OJ L 201, 27.7.2012, p. 1).
[4] Commission Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and of the Council with regard to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to a trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts not cleared by a CCP (OJ L 52, 23.2.2013, p. 11).

contracts. As a result, hedging of a risk may be achieved by a combination of commodity derivative contracts including offsetting commodity derivative contracts that close out those commodity derivative contracts that have become unrelated to the commercial risk. Additionally the evolution of a risk that has been addressed by the entering into of a position in a commodity derivative for the purpose of reducing that risk should not subsequently give rise to the re-evaluation of that position as being not a privileged transaction ab initio.

(16) For reasons of consistency and in order to ensure the smooth functioning of the financial markets, it is necessary that the provisions laid down in this Regulation and the related national provisions transposing Directive 2014/65/EU apply from the same date.

~~(16) The new legislation of the European Parliament and of the Council on markets in financial instruments set out in Directive 2014/65/EU and Regulation (EU) No 600/2014 of the European Parliament and of the Council[5] applies from 3 January 2017. To ensure consistency and legal certainty, this Regulation should apply from the same date.~~

(17) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.

(18) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[6].

HAS ADOPTED THIS REGULATION:

Article 1

Application of thresholds

The activities of a person referred to in points (i) and (ii) of Article 2(1)(j) of Directive 2014/65/EU shall be considered to be ancillary to the main business of the group if that person meets the conditions set out in Article 2 and that person's activities constitute a minority of activities at group level in accordance with Article 3.

Article 2

~~[5] Regulation (EU) No 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 (OJ L 173, 12.6.2014, p. 84).~~

[6] Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC (OJ L 331, 15.12.2010, p. 84).

Trading activity threshold

1. The size of the trading activity calculated in accordance with paragraph 2 divided by the overall market trading activity calculated in accordance with paragraph 3 shall, in each of the following asset classes, account for less than the following values:

(a) 4 % in relation to derivatives on metals;

(b) 3 % in relation to derivatives on oil and oil products;

(c) 10 % in relation to derivatives on coal;

(d) 3 % in relation to derivatives on gas;

(e) 6 % in relation to derivatives on power;

(f) 4 % in relation to derivatives on agricultural products;

(g) 15 % in relation to derivatives on other commodities, including freight and commodities referred to in Section C 10 of Annex I to Directive 2014/65/EU;

(h) 20 % in relation to emission allowances or derivatives thereof.

2. The size of the trading activity undertaken in the Union by persons within a group in each of the asset classes referred to in paragraph 1 shall be calculated by aggregating the gross notional value of all contracts within the relevant asset class to which those persons are a party.

The aggregation referred to in the first subparagraph shall not include contracts resulting from transactions referred to in points (a), (b) and (c) of the fifth subparagraph of Article 2(4) of Directive 2014/65/EU and transactions executed in an ~~entitiy~~ entity of the group authorised in accordance with Directive 2014/65/EU or Directive 2013/36/EU.

3. The overall market trading activity in each of the asset classes referred to in paragraph 1 shall be calculated by aggregating the gross notional value of all contracts that are not traded on a trading venue within the relevant asset class to which any person located in a Member State is a party and of any other contract within that asset class that is traded on a trading venue located in a Member State~~–~~.

4. The gross notional value shall be denominated in EUR.

Article 3

Main business threshold

1. Ancillary activities shall be considered to constitute a minority of activities at group level compared ~~to~~with the main business of the group where the size of the trading activities

calculated in accordance with paragraph 34 does not account for more than 10% of the total size of the trading activity of the group calculated in accordance with paragraph 4.

2. By way of derogation from paragraph 1,

(a) where the size of the trading activities calculated in accordance with paragraph 34 accounts for more than 10% but less than 50% of the total size of the trading activity of the group calculated in accordance with paragraph 4, ancillary activities shall be considered to constitute a minority of activities at group level only where the size of the trading activity for each of the asset classes referred to in Article 2(1) accounts for less than 50% of the threshold established by Article 2(1) of the overall market~~'s~~ size in the relevant asset class.

(b) where the size of the trading activity calculated in accordance with paragraph 34 accounts for equal to or more than 50% of the size of the trading activity calculated in accordance with paragraph 4, ancillary activities shall be considered to constitute a minority of activities at group level only where the size of the trading activity for each of the asset classes referred to in Article 2(1) accounts for less than 20% of the threshold established by Article 2(1) of the overall market's size in the relevant asset class.

3. The size of the activities in the Union referred to in points (i) and (ii) of Article 2(1)(j) of Directive 2014/65/EU undertaken by persons within a group shall be calculated by aggregating the trading activity undertaken by those persons in all of the asset classes referred to in Article 2(1) in accordance with the same calculation criteria as that referred to in Article 2(2).

4. The total size of the trading activity in the Union undertaken by persons within a group shall be calculated by aggregating the gross notional value of all contracts in ~~financial instruments~~commodity derivatives, emission allowances and derivatives thereof to which persons within that group are a party to. The aggregation shall not include transactions executed in an entity of the group authorised in accordance with Directive 2014/65/EU or Directive 2013/36/EU.

5. The gross notional value shall be denominated in EUR.

Article 4

Procedure for calculation

1. The calculation of the size of the trading activities referred to in Articles 2 and 3 shall be undertaken annually on the basis of a simple average of the trading activities carried out in the three annual calculation periods preceding the date of calculation.

2. By derogation to paragraph 1, the calculation of the size of the trading activities shall be undertaken on the following basis:

(a) before 1 July ~~2017~~2018, it shall only take into account the trading activities carried out from 1 July 201~~6~~5 to 30 June 201~~7~~6;

(b) between 1 July ~~2017~~ 2018 and 30 June 201~~8~~9 it shall only take into account the simple average of two annual calculation periods based on the trading activities carried out from ~~the calendar year of~~ 1 July 201~~5~~6 to 30 June 201~~8~~7;

(c) ~~In the case of~~should a pers~~i~~on ~~that~~ ha~~ve~~s~~s~~ no trading activity prior to an annual calculation period referred to in subparagraph (b) or paragraph 1, it shall only ~~take into account~~include trading activities carried out in the annual calculation period in which that person commenced trading and any following annual calculation period.

3. For the purposes of paragraphs 1 and 2, references to an 'annual calculation period' mean~~s~~ a period which starts on 1 July of a given year and ends on 30 June in the following year.

Article 5

Transactions qualifying as reducing risks

1. For the purposes of point (b) of the fifth subparagraph of ~~point (b) of~~ Article 2(4)~~,~~ of Directive 2014/65/EU, a transaction in derivatives shall be considered ~~to reduce~~ objectively measurable as reducing risks directly relating to commercial activity or treasury financing activity when one or more of the following criteria are met:

(a) it reduces the risks arising from the potential change in the value of assets, services, inputs, products, commodities or liabilities that the person or its group owns, produces, manufactures, processes, provides, purchases, merchandises, leases, sells, or incurs or reasonably anticipates owning, producing, manufacturing, processing, providing, purchasing, merchandising, leasing, selling or incurring in the normal course of its business;

(b) it covers the risks arising from the potential indirect impact on the value of assets, services, inputs, products, commodities or liabilities referred to in point (a), resulting from fluctuation of interest rates, inflation rates, foreign exchange rates or credit risk;

(c) it qualifies as a hedging contract pursuant to International Financial Reporting Standards adopted in accordance with Article 3 of Regulation (EC) No 1606/2002 of the European Parliament and Council.

2. For the purposes of paragraph 1, a qualifying risk-reducing transaction taken on its own or in combination with other derivatives is one for which the non-financial entity:

(a) describes the following in its internal policies:

(i) the types of commodity derivative contracts included in the portfolios used to reduce risks directly relating to commercial activity or treasury financing activity and their eligibility criteria;

(ii) the link between the portfolio and the risks that the portfolio is mitigating;

(iii) the measures adopted to ensure that the transactions concerning those contracts serve no other purpose than covering risks directly related to the commercial activit~~i~~y~~es~~ or the treasury financing activity of the non-financial entity, and that any transaction serving a different purpose can be clearly identified;

(b) is able to provide a sufficiently disaggregate view of the portfolios in terms of class of commodity derivative, underlying commodity, time horizon and any other relevant factors.

Article 6

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

This Regulation shall apply from the date that appears first in the second subparagraph of Article 93(1) of Directive 65/2014/EU.

~~It shall apply from 3 January 2017.~~

Done at Brussels,

For the Commission
The President

[For the Commission
On behalf of the President

[Position]