European Securities and Markets Authority

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PUBLIC STATEMENT

Impact of Brexit on MiFID II/MiFIR and the Benchmark Regulation (BMR) – C(6) carve-out, trading obligation for derivatives, ESMA opinions on third-country trading venues for the purpose of post-trade transparency and position limits, post-trade transparency for OTC transactions, BMR ESMA register of administrators and 3rd country benchmarks

The European Securities and Markets Authority (ESMA) is issuing this statement in relation to ESMA's approach to the application of some key MiFID II/MiFIR and BMR provisions in case the United Kingdom (UK) leaves the European Union (EU) on 29 March 2019 at midnight without a withdrawal agreement (no deal Brexit).

The following MiFID II aspects are covered in this statement: the trading obligation for derivatives, the C(6) carve-out, the ESMA opinions on third-country trading venues for the purpose of post-trade transparency and the position limits regime and post-trade transparency for OTC transactions. This statement also covers the ESMA register of administrators and 3rd country benchmarks under the Benchmark Regulation (BMR).

There is still uncertainty as to the final timing and conditions of Brexit. Should the timing and conditions of Brexit change, ESMA may adjust the approach and would inform the public of the adjusted approach as soon as possible.

The MiFID II "C(6) carve-out"

To be eligible to the exemption set out in Section C(6) of Annex I of MiFID II and not to be considered as a financial instrument, a derivative contract must meet three conditions i) it must qualify as a wholesale energy product (ii) it must be traded on an OTF and iii) it must be physically settled.

A no-deal Brexit will have an impact on the first two conditions. Firstly, "wholesale energy product" is defined in Article 6(3) of Commission Delegated Regulation 2017/565[1] which refers

[1] COMMISSION DELEGATED REGULATION (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

to Article 2(4)(b) and (d) of REMIT. Under those REMIT provisions, the following contracts are considered to be wholesale energy products: derivatives relating to electricity or natural gas produced, traded or delivered in the Union; and derivatives relating to the transportation of electricity or natural gas in the Union, irrespective of where those derivatives are traded.

As a consequence, a derivative contract related to electricity or natural gas that would be exclusively produced, traded and delivered in the UK would no longer qualify as wholesale energy product post-Brexit and would no longer be eligible to the C(6) carve-out under MiFID II, even if traded on an EU27 OTF. However, where, for instance, UK natural gas would continue to be traded on a spot trading platform in the EU27 post-Brexit, derivatives on UK natural gas would continue to qualify as "wholesale energy products" under Article 2(4) of REMIT and could benefit from the C(6) carve-out in MiFID II.

Secondly, to be eligible to the carve-out, the wholesale energy product must be traded on an OTF. Accordingly, where a wholesale energy product would not be traded on an EU27 OTF post-Brexit, it would cease to be eligible to the C(6) carve-out under MiFID II.

Where a derivative contract based on electricity or natural gas would no longer be eligible to the C(6) carve-out under MiFID, it may become a financial instrument under Section C(6) if traded on an EU regulated market or multilateral trading facility or traded on an EU OTF without meeting the REMIT definition. A derivative contract no longer eligible to the C(6) carve-out may also become a financial instrument under Section C(7) of Annex I of MiFID II if, among other things, it has the "characteristics of other derivative financial instruments" as further defined in Article 7 of Commission Delegated Regulation 2017/565.

Trading obligation for derivatives

Article 28 of MiFIR requires investment firms to conclude transactions in some derivatives on regulated markets ("RMs"), multilateral trading facilities ("MTFs"), organised trading facilities ("OTFs") or third-country venues established in jurisdictions for which the European Commission has adopted an equivalence decision. The classes of derivatives subject to the trading obligation are specified in Commission Delegated Regulation (EU) 2017/2417 and cover certain fixed-to-float interest rate swaps denominated in EUR, USD and GBP and two credit default swap indices. Currently, most trading venues that allow for the execution of instruments subject to the trading obligation in the EU are based in the UK. Moreover, the large

majority of trading in derivatives subject to the trading obligation is concluded on UK trading venues.

ESMA understands that most UK trading venues that offer trading in derivatives subject to the trading obligation are in the process of establishing new trading venues in the EU27 and plan to offer the same product portfolio in the EU27 as they are currently offering in the UK. In addition, there are already trading venues in the EU27 offering trading in derivatives subject to the trading obligation.

ESMA does not have, at this point in time, any evidence that market participants will not be able to continue meeting their obligations under the trading obligation for derivatives in case of a no-deal Brexit and in the absence of an equivalence decision by the Commission covering UK trading venues. Nevertheless, ESMA will continue to monitor closely how liquidity develops post-Brexit and whether markets will be sufficiently liquid to allow EU27 market participants to execute transactions in derivatives subject to the trading obligation on eligible trading venues.

ESMA opinions on post-trade transparency and position limits

In case of a no-deal Brexit, trading venues established in the UK will with effect from 30 March 2019 no longer be considered EU trading venues. Consequently, transactions concluded on UK trading venues would be considered OTC-transactions and would be subject to the post-trade transparency requirements pursuant to Articles 20 and 21 of MiFIR. Furthermore, commodity derivatives traded on UK trading venues could, subject to meeting certain conditions, be considered as EEOTC contracts for the EU27 position limit regime.

In order to avoid double-reporting and including commodity derivatives contracts traded on third-country trading venues in the position limit regime, ESMA published in 2017 two opinions on third-country trading venues in the context of MiFID II/MiFIR (ESMA70-154-467, ESMA70-156-466). The first opinion clarified that investment firms trading on third-country trading venues meeting a set of criteria are not required to make transactions public in the EU via an approved publication arrangement (APA). The second opinion clarified that commodity derivatives contracts traded on third-country trading venues meeting a set of criteria are not considered as economically equivalent over-the-counter (EEOTC) contracts for the position limit regime.

Since the UK is currently a member of the EU, ESMA has not assessed any UK trading venue against the criteria set out in the two opinions so far. However, ESMA stands ready, based on requests from EU27 market participants, to carry out such assessments. Pending the publication of the outcome of such assessments, EU27 investment firms will not be required to make transactions public in the EU27 via an EU APA that are executed on an UK trading venue. Commodity derivatives contracts traded on those trading venues will not be considered as EEOTC contracts for the EU27 position limit regime.

Post-trade transparency for OTC transactions between EU investment firms and UK counterparties

The obligations under Articles 20 and 21 of MiFIR for EU investment firms to publish transactions in instruments that are traded on a trading venue (TOTV) via an APA applies also to OTC-transactions involving an EU investment firm and a counterparty established in a third-country.[2]

In case of a no-deal Brexit investment firms established in the UK will no longer be considered EU investment firms but will fall into the category of counterparties established in a third country. In consequence, EU investment firms are required to make public transactions concluded OTC with UK counterparties via an APA established in the EU27. This approach ensures that all transactions where at least one counterparty is an EU investment firm will be made post-trade transparent in the EU27.

BMR: ESMA register of administrators and 3rd country benchmarks

[2] See Q&A 2 of section 9 of the MiFID transparency Q&As; https://www.esma.europa.eu/sites/default/files/library/esma70-872942901-35_qas_transparency_issues.pdf

In case of a no-deal Brexit, UK administrators included in the "*ESMA register of administrators and third-country benchmarks*" (ESMA register)[3] before the date of the no-deal Brexit will be deleted from the ESMA register. Those UK administrators were originally included in the ESMA register as EU administrators, but after a no-deal Brexit they would qualify as 3rd country administrators (for which the BMR foresees different regimes to be included in the ESMA register).

However, during the BMR transitional period (as defined in BMR Article 51[4]) this change of the ESMA register would not have an effect on the ability of EU27 supervised entities to use the benchmarks provided by those UK administrators. This is because during the BMR transitional period EU supervised entities can use 3rd country benchmarks even if they are not included in the ESMA register. This BMR provision would be applicable also to the benchmarks provided by the UK administrators deleted from the ESMA register because of a no-deal Brexit.

Similarly, if some 3rd country benchmarks were included in the ESMA register before the date of a no-deal Brexit following a recognition or an endorsement status granted in the UK, those 3rd country benchmarks will be deleted from the ESMA register on the date of no-deal Brexit. The BMR transitional period is also applicable to these 3rd country benchmarks. Therefore, during the BMR transitional period this change of the ESMA register would not have an effect on the ability of EU27 supervised entities to use the 3rd country benchmarks that were endorsed or recognised in the UK before the date of a no-deal Brexit.

[3] ESMA register of administrators and third country benchmarks is available here: https://www.esma.europa.eu/databases-library/registers-and-data

[4] See also Q&A 9.3 of ESMA BMR Q&As: https://www.esma.europa.eu/sites/default/files/library/esma70-145-114_qas_on_bmr.pdf