European Securities and Markets Authority

1 October 2020
ESMA70-155-10962

PUBLIC STATEMENT

Impact of Brexit on the application of MiFID II/MiFIR

The European Securities and Markets Authority (ESMA) is issuing this statement in relation to its approach to the application of some key MiFID II/MiFIR provisions after the end of the Transition Period on 31 December 2020 provided for in the Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (withdrawal agreement).

This statement updates the issues covered in the statement published on 7 March and 7 October 2019.The following MiFID II aspects are covered in this statement:

- 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 ITS on main indices and recognised exchanges under the Capital Requirement Regulation (CRR).

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.

The end of the transition period 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 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 EU; and derivatives relating to the transportation of electricity or natural gas in the EU, 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 after the end of the transition period and would no longer be eligible to the C(6) carve-out under MiFID II, even if traded on an EU OTF. However, where, for instance, UK natural gas would continue to be traded on a spot trading platform in the EU after the end of the transition period, derivatives relating to the above-mentionned 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 since they would be derivatives relating to gas traded in the EU.

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 EU OTF after the end of the transition period, 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.

[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

ESMA opinions on post-trade transparency and position limits

Following the end of the transition period, trading venues established in the UK will, with effect from 1 January 2021, no longer be considered EU trading venues. Consequently, transactions concluded on UK trading venues would be considered OTC-transactions and 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 EU position limit regime.

In order to avoid double-reporting and including commodity derivative 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 derivative 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.

In June 2020, ESMA published the lists of third-country venues meeting the relevant criteria of both opinions.

While the UK was a member of the EU and during the transition period, ESMA did not assess any UK trading venue against the criteria set out in the two opinions. However, ESMA intends to perform such assessments of UK venues before the end of the transition period. UK venues would be added to the respective lists of positively assessed third-country venues provided that they meet all the relevant criteria.

As a result, after the end of the transition period, EU investment firms would not be required to make transactions public in the EU via an EU APA if they are executed on a UK trading venue that has been positively assessed. Commodity derivative contracts traded on those trading venues would not be considered as EEOTC contracts for the EU position limit regime.

ESMA reiterates the technical nature of the assessment which is independent from and not related to the European Commission’s decisions on equivalence.

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 apply also to OTC-transactions involving an EU investment firm and a counterparty established in a third-country[2].

Following the end of the transition period 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 EU. This approach ensures that all transactions where at least one counterparty is an EU investment firm will be made post-trade transparent in the EU.

CRR: ITS on main indices and recognised exchanges

The CRR tasks ESMA with defining the concepts of "main indices" and "recognised exchanges" in the specification of eligible collateral. These concepts are key for the calculation of credit risk by credit institutions and investment firms for which the CRR applies. Commission Implementing Regulation 2016/1646 (the ITS) sets out a list of the main indices and recognised exchanges for the purpose of the CRR. ESMA recently consulted on a potential amendment of the CRR ITS to reflect market changes over the last years and Brexit[3].

A recent amendment to the CRR provides for the possibility to include third country trading venues in the list of recognised exchanges subject to an equivalence decision of the Commission. However, following the end of the transition period and in the absence of such an equivalence decision, UK exchanges would no longer be included in the list of recognised exchanges .

ESMA submitted the Final Report on the amendment to the CRR ITS to the Commission on 11 December 2019 which contained two scenarios depending on the Brexit outcome. The first version of the ITS included UK exchanges and covers the scenario of the Commission adopting

[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
[3] https://www.esma.europa.eu/sites/default/files/library/esma70-156-864_cp_amending_its_on_main_indices_and_recognised_exchanges_under_crr.pdf

an equivalence decision. The second version of the ITS covered the scenario of the Commission not adopting an qequivalence decisions and excluded UK exchanges. The final decision was left to the Commission on the basis of the timing and conditions of Brexit. To date, the Commission has not yet endorsed the amendments to the CRR ITS.