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COMMISSION DELEGATED REGULATION (EU) .../...

of 26.5.2016

supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on criteria for determining whether derivatives subject to the clearing obligation should be subject to the trading obligation

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) No 600/2014 on Markets in Financial Instruments ('MiFIR') lays down a trading obligation applicable to non-intra group transactions in sufficiently liquid contracts when traded by counterparties subject to clearing under Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ('EMIR'). The application of the trading obligation is defined under Article 32 MiFIR, which outlines the process for deciding which derivatives should be declared subject to mandatory trading. Once a class of derivatives has been mandated as subject to the clearing obligation under EMIR, ESMA must determine whether those derivatives (or a subset of such) should be subject to the trading obligation, meaning they can only be traded on a regulated market, multilateral trading facility, organised trading facility, or a third country trading venue deemed to be equivalent by the Commission. In summary, whether or not a class of derivatives subject to the clearing obligation should also be made subject to the trading obligation will be determined by two main factors:

- The venue test: the class of derivatives must be admitted to trading or traded on at least one admissible trading venue; and
- The liquidity test: whether the derivatives are “sufficiently liquid” and there is sufficient third party buying and selling interest.

There are no provisions that specify when derivatives subject to the clearing obligation should be subject to the trading obligation in Directive 2004/39/EC on Markets in Financial Instruments 'MiFID'.

In this context, Article 32 of MiFIR empowers the Commission to adopt, following submission of draft standards by the European Securities and Markets Authority (ESMA), and in accordance with Articles 10 to 15 of Regulation No (EU) 1095/2010, delegated acts to further specify the criteria for the determination of sufficient third-party buying and selling interest in a class of derivatives or a relevant subset of a class of derivatives.

The draft regulatory technical standards were submitted to the Commission on 28 September 2015. In accordance with Article 10(1) of Regulation No (EU) 1095/2010 establishing ESMA, the Commission shall decide within three months of receipt of the draft standards whether to endorse them. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with Article 10 of the Regulation (EU) 1095/2010 ESMA has carried out a public consultation on the draft regulatory technical standards. A consultation paper was published on 19 December 2014 on ESMA website and the consultation closed on 2 March 2015. In addition, ESMA sought the views of the Securities and Markets Stakeholder Group (SMSG) established in accordance with Article 37 of the ESMA Regulation. The SMSG chose not to provide advice on these issues due to the technical nature of the standards.

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation (EU) No 1095/2010, ESMA has submitted its impact assessment, including the analysis of costs and benefits related to the draft technical standards. This analysis is available at http://www.esma.europa.eu/system/files/2015-esma-1464_annex_ii_-_cba_-_draft_rts_and_its_on_mifid_ii_and_mifir.pdf.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The right to adopt a delegated Regulation is provided for under Article 32(6) of MiFIR. Under this provision, the Commission is empowered to adopt a delegated Regulation to further specify the criteria to determine whether derivatives subject to the clearing obligation should be subject also to the trading obligation.

In this context, this delegated Regulation provides clarity in the determination of a class of derivatives or relevant subset thereof which is sufficiently liquid, in particular, through specifying the criteria with respect to the average frequency of trades (Article 2), average size of trades (Article 3), number and type of active market participants (Article 4) and average size of spreads (Article 5), which together indicate the level of third-party buying and selling interest (Article 1).

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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to 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 648/2012¹, and in particular Article 32(6) thereof,

Whereas:

- (1) This Regulation contributes to the specification of the criteria for the determination of sufficient third-party buying and selling interest in a class of derivatives or a relevant subset of a class of derivatives. Where the European Securities and Markets Authority (ESMA) has established that a class of derivatives should be subject to the clearing obligation under Regulation (EU) No 648/2012 of the European Parliament and of the Council² and that the derivatives are admitted to trading or traded on a trading venue, ESMA should follow the criteria in this Regulation to determine whether the derivatives or subset thereof are considered sufficiently liquid to trade exclusively on trading venues.
- (2) Regulation (EU) No 648/2012 sets out that derivatives are considered to be executed on an OTC basis when they are not traded on, or not subject to the rules of, a regulated market, whereas the definition of derivatives executed over-the-counter (OTC) under Directive 2014/65/EU of the European Parliament and of the Council³ is narrower, comprising derivatives not traded on, or not subject to the rules of, a regulated market, multilateral trading facility (MTF) or organised trading facility (OTF). ESMA should therefore assess the extent to which trades are executed already on trading venues in a class of derivatives or a relevant subset thereof and compare this to the level of trading not executed on a trading venue. The prevalence of trading outside a trading venue should not, however, automatically establish that a class of derivatives or a relevant subset thereof is not suitable for the trading obligation. ESMA should have regard also to the anticipated impact of the trading obligation considering both the possibility to promote liquidity and market integrity through increased transparency and availability

¹ OJ L 173, 12.6.2014, p. 84.

² 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)

³ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12.6.2014, p. 349.

of the financial instruments, as well as the potential negative consequences of such a decision.

- (3) Given the similarity of the definition of a liquid market for non-equities under Article 2(17)(a) of Regulation (EU) No 600/2014 to the criteria for determining whether a class of derivatives or subset thereof is sufficiently liquid under Article 32(3) of that Regulation, the assessment undertaken for one should be taken into consideration for the other to promote consistency in the treatment of instruments. However, a class of derivatives or subset thereof deemed to have a liquid market for transparency purposes should not be deemed automatically to be sufficiently liquid for the trading obligation. The quantitative thresholds and qualitative weightings may differ, taking into account the different objectives of the assessments.
- (4) Given the wide range of instruments potentially affected by the trading obligation for derivatives and their specific characteristics, the constant evolution of financial markets and the variety of national markets involved, it is not possible to determine for each and every derivative type an exhaustive list specifying the elements relevant to an assessment of third-party buying and selling interest or the weighting to be given to any particular element.
- (5) However, a degree of clarity should be provided for the determination of a class of derivatives or relevant subset thereof which is sufficiently liquid, in particular, through specifying the criteria with respect to average frequency of trades, average size of trades, number and type of active market participants and average size of spreads, which together indicate the level of third-party buying and selling interest.
- (6) The observation period for determining whether a class of derivatives or relevant subset thereof is sufficiently liquid to trade exclusively on trading venues should vary depending on the class of derivatives or relevant subset thereof concerned. It should be sufficiently long to ensure that the data collected is not skewed by any type of events that may cause unusual trading patterns. In any circumstance the observation period should not be shorter than three months.
- (7) The criteria described in this Regulation should be designed so that the assessment of one derivative or classes of derivatives may be compared with other derivatives or classes of derivatives with similar characteristics. The identification of classes of derivatives with similar characteristics may include a number of elements such as the currency in which they are traded, maturity dates, the starting term of the contracts' tenor, whether they follow a standard convention or not, and whether they are on-the-run contracts.
- (8) ESMA should refer to historical data indicating shifts in liquidity to determine both whether the class of derivatives or subset thereof is sufficiently liquid to trade only on venues and whether it is only sufficiently liquid in transactions below a certain size. The thresholds for these assessments may vary between classes of derivatives or subsets thereof where the characteristics and the notional size of the classes or subsets vary. In its assessment of spreads, ESMA should have regard to both the average size and the availability of spreads, balancing the consideration that a lack of or wide spreads indicate insufficient liquidity against the possibility that spreads may become narrower through increased transparency and the availability of the financial instruments if the trading obligation is introduced.
- (9) In its assessment, ESMA should remove from its calculations those trades which are clearly identifiable as post-trade risk reduction trades which reduce non-market risks

in derivatives portfolios. To include such transactions in the assessment for the trading obligation may otherwise result in an inflated view of the level of third party buying and selling interest.

- (10) ESMA should also take into consideration the need or otherwise to permit package transactions during its assessment. Investment firms often conduct, on their own account or on behalf of clients, transactions in derivatives and other financial instruments that comprise a number of interlinked trades which are contingent on one another. Given that package transactions enable investment firms and their clients to manage their risks and improve the resiliency of financial markets, it may be desirable to continue to permit the execution of some package transactions which comprise one or more derivatives subject to the trading obligation to be executed, on a bilateral basis, outside a trading venue.
- (11) Criteria should also be set out to enable ESMA to determine whether an existing trading obligation for a class of derivatives or a relevant subset thereof should be amended, suspended or revoked, unless the class of derivatives or a relevant subset thereof is no longer traded on at least one trading venue.
- (12) For reasons of consistency and legal certainty, it is necessary that the provisions of this Regulation and the provisions laid down in Directive 2014/65/EU and Regulation (EU) No 600/2014 apply from the same date.
- (13) This Regulation is based on the draft regulatory technical standards submitted by the ESMA to the Commission.
- (14) 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 Council⁴.

HAS ADOPTED THIS REGULATION:

Article 1

Sufficient third party buying and selling interest

When establishing whether a class of derivatives or relevant subset thereof has sufficient third-party buying and selling interest to be considered sufficiently liquid for the trading obligation, ESMA shall apply the criteria in Article 32(3) of Regulation (EU) No 600/2014, as further specified in Articles 2 to 5 below.

Article 2

Average frequency of trades

1. In relation to the average frequency of trades, ESMA shall take into consideration the following elements:
 - (a) the number of days on which trading took place;
 - (b) the number of trades.

⁴ 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).

2. ESMA analysis of the criteria in paragraph 1 shall take into account the distribution of trading executed on trading venues and executed OTC. ESMA shall assess these criteria over a period of time of sufficient length to determine whether the liquidity of each class of derivatives or a relevant subset thereof is subject to seasonal or structural factors. ESMA shall also consider whether trades are concentrated at certain points in time and over certain sizes over the period assessed and determine to what extent such concentration constitutes predictable patterns.

Article 3

Average size of trades

1. In relation to the average size of trades, ESMA shall take into consideration the following elements:
 - (a) the average daily turnover whereby the notional size of all trades combined shall be divided by the number of trading days;
 - (b) the average value of trades whereby the notional size of all trades combined shall be divided by the number of trades.
2. ESMA analysis of the criteria in paragraph 1 shall take into account the factors specified in Article 2(2).

Article 4

Number and type of active market participants

1. In relation to the number and type of active market participants, ESMA shall take into consideration the following elements:
 - (a) the total number of market participants trading in that class of derivatives or relevant subset thereof is not lower than two;
 - (b) the number of trading venues that have admitted to trading or are trading the class of derivatives or a relevant subset thereof;
 - (c) the number of market makers and other market participants under a binding written agreement or an obligation to provide liquidity.
2. ESMA analysis shall compare the ratio of market participants to the findings in the data obtained for the analyses of average size of trades and the average frequency of trades.

Article 5

Average size of spreads

1. In relation to the average size of spreads, ESMA shall take into consideration the following elements:
 - (a) the size of weighted spreads, including volume weighted spreads, over different periods of time;
 - (b) spreads at different points in time of trading sessions.
2. Where information on spreads is not available, ESMA shall take into consideration a proxy for the assessment of this criterion.

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 referred to in the second paragraph of Article 55 of Regulation (EU) No 600/2014.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 26.5.2016

For the Commission
The President
Jean-Claude JUNCKER