PUBLIC STATEMENT

Impact of no-deal Brexit on the application of MiFID II/MiFIR and the Benchmark Regulation (BMR)

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 and BMR provisions in the event the United Kingdom (UK) leaves the European Union (EU) on 31 October 2019 without a withdrawal agreement (no-deal Brexit). There is still uncertainty, at the time of publication, as to the final timing and conditions of Brexit, should those change, ESMA may adjust its approach and inform the public of this adjusted approach as soon as possible.

This statement updates the issues covered in the statement published on 7 March 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 and the ESMA register of administrators and 3rd country benchmarks under the Benchmark Regulation (BMR).

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 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 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.

**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 1 November 2019, 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 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

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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.

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.

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, in case of a no-deal Brexit and in the absence of such an equivalence decision, UK exchanges would no longer be included in the list of recognised exchanges.

ESMA will only be in a position to submit of the Final Report on the amendment to the ITS to the Commission, and to decide on including or excluding UK exchanges, once there is more certainty on the timing and conditions of Brexit.

BMR: ESMA register of administrators and 3rd country benchmarks

In case of a no-deal Brexit, UK administrators included in the “ESMA register of administrators and third-country benchmarks” (ESMA register) 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) this change of the ESMA register would not have an effect on the ability of EU27 supervised entities to use the

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