European Securities and Markets Authority

Date: 21 March 2018
ESMA70-156-322

OPINION

On the treatment of packages under the trading obligation for derivatives

1 Legal basis

1. ESMA's competence to deliver an opinion to competent authorities is based on Article 29(1)(a) of Regulation (EC) 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)[1] (ESMA Regulation).

2. Pursuant to Article 29(1)(a) of the ESMA Regulation, ESMA shall provide opinions to competent authorities for the purpose of building a common Union supervisory culture and consistent supervisory practices, as well as ensuring uniform procedures and consistent approaches throughout the Union.

2 Background

3. Article 28 of Regulation (EU) No 600/2014[2] (MiFIR) introduces a requirement to trade derivatives that have been declared subject to the trading obligation in accordance with the procedure set out in Article 32 of MiFIR on regulated markets, multilateral trading facilities (MTFs), organised trading facilities (OTFs) or on equivalent third-country trading venues.

4. According to the mandate in Article 32 of MiFIR, ESMA developed draft regulatory technical standards (RTS) specifying the classes of derivatives subject to the trading obligation. The Commission adopted Commission Delegation Regulation 2017/2417[3] on 17 November 2017. The trading obligation for derivatives (TO) started applying for counterparties of category 1 and 2 on 3 January 2018 for the following classes of derivatives:

    - Fixed-to-float interest rate swaps (IRS) denominated in EUR, GBP and USD for the main benchmark tenors;

[1] OJ L 331, 15.12.2010, p. 84
[2] 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).
[3] Commission Delegated Regulation (EU) 2017/2417 of 17 November 2017 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 the trading obligation for certain derivatives (OJ L 343, 22.12.2017, p. 48).

- Index credit default swaps (CDS): iTraxx Europe Main, iTraxx Europe Crossover.

5. During the development of the draft RTS and after its submission to the Commission, market participants asked ESMA for guidance on the treatment of packages under the TO. ESMA agreed that clarity was needed regarding the treatment of packages for the purposes of the TO but, in the absence of a specific mandate to provide such a guidance in this context, could not provide for a tailored regime for packages in the draft RTS specifying the TO.[4]

6. In its declaration of non-objection to Commission Delegation Regulation 2017/2417 the European Parliament considered that further clarification might be needed by the Commission and ESMA on the treatment of packages and that such guidance should be in line with the provisions laid down in Regulation (EU) 2016/1033[5] (Quick Fix Regulation).

7. Furthermore, ESMA has received concerns from competent authorities and market participants that the absence of further clarification on the treatment of packages under the TO might result in severe inconsistencies in the application of the TO, also to the detriment of trading those packages.

8. ESMA has considered that such clarification will contribute positively to the consistency of supervisory practices and will ensure consistent approaches throughout the Union, as a result of which, ESMA has decided to issue this Opinion.

3 Opinion

9. Package orders and package transactions ('packages') are defined respectively in points (49) and (50) of Article 2(1) of MiFIR. As it results from these provisions, in particular, packages include two or more financial instruments, where each component bears meaningful economic or financial risk to all the other components and the execution of each component is simultaneous and contingent upon on the execution of all the other components.

10. ESMA notes that the TO as specified in Commission Delegation Regulation 2017/2417 is designed to apply at the level of a financial instrument and not at the level of the package. Therefore, only components of a package are subject to the TO, but not the package as such (i.e. the other components of the package).

[4] See p. 9 of ESMA70-156-227, Final report, draft RTS on the trading obligation for derivatives, 28.September2017, https://www.esma.europa.eu/sites/default/files/library/esma70-156-227_final_report_trading_obligation_derivatives.pdf; and p. 26-29, ESMA70-156-71, Consultation Paper, The trading obligation for derivatives under MiFIR, https://www.esma.europa.eu/sites/default/files/library/esma70-156-71_cp_trading_obligation.pdf.

[5] Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments , Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories, OJL175, 30.6.2016,p.1.

11. Packages are a relevant part of today's financial markets by enabling investment firms and their clients to conduct trades for risk management and hedging purposes. ESMA considers it important to ensure that investment firms can continue trading packages that include components subject to the TO, while at the same time not undermining the policy objective of trading standardised derivatives on trading venues.

12. On the one hand, many MTFs and OTFs that offer trading in derivatives subject to the TO make also categories of packages available for trading. These include for IRS inter alia swap spreads (i.e. a package composed of two IRS), butterflies (i.e. a package composed of three IRS) spread overs (i.e. a package composed of an IRS and a government bond) and invoice spreads (i.e. a package composed of an IRS and a future contract on a government bond). Furthermore, some MTFs/OTFs offer trading in packages composed of credit derivatives such as rolls (i.e. replacing the position in the latest off-the run contract with a position in the on-the-run contract) and butterflies (i.e. a package composed of three CDS contracts with different maturities). While those packages may be traded on OTFs/MTFs using different execution methods, it should be noted that MiFIR does not prescribe a specific execution method.

13. On the other hand, it has to be recognised that breaking down components of packages and executing them in multiple places may introduce significant complexity into the system and increase operational and execution risks. Hence, it needs to be ensured that the necessary protocols and processes are in place to allow for the smooth execution of the components of such packages prior to requiring the derivative component(s) subject to the TO to be concluded on a trading venue.

14. ESMA therefore suggests a tailored approach ensuring that, only where it is feasible to trade components of a package that are subject to the TO on a trading venue without creating undue operational or execution risk, those components need to be concluded on a trading venue. This approach applies to the following categories of packages:

   - All components of the package are subject to the TO;
   - At least one component is subject to the TO and all other components are subject to the clearing obligation for derivatives (CO);
   - At least one component is an IRS subject to the TO and all other components are government bonds denominated in the same currency ('spread overs').

15. ESMA may review this opinion should there be indications that it is feasible to execute categories of packages different to those specified above in a smooth manner and without increasing operational and execution risks.