Joint Associations' Questions & Answers (Q&A) on Regulatory Technical Standard (RTS) 20 of the Markets in Financial Instruments Directive (MiFID II)

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It is apparent from discussions amongst market participants that the three key Ancillary Activity Tests in MIFID II RTS 20 are open to diverse interpretations which are unintended by the ESMA and Commission drafting. Therefore, the following seven associations put forward the following joint Q+As with regard to MiFID II RTS 20 and would be happy to discuss these with you:

Bundesverband der Energie- und Wasserwirtschaft (BDEW), European Federation of Energy Traders (EFET), EURELECTRIC, Energy UK, EUROGAS, Futures Industry Association (FIA) and International Oil and Gas Producers association (IOGP).

In particular, these associations put forward the following Q+As with regard to the three "Ancillary Activity Tests", which are the (1) "Overall Market Threshold Test" (article 2 RTS 20) and the two alternative Main Business Threshold Tests, i.e., (2) the "Proxy Test" (article 3 (1) (a) RTS 20) and (3) the "Capital Employed Test" (article 3 (1) (b) RTS 20).

If ESMA wishes there to be consistent application of these Ancillary Activity Tests then further Q&A is required to mitigate the risk of inaccurate interpretations being applied.

1. Personal scope of the numerator of the Ancillary Activity Tests

Question: Is the numerator of the Overall Market Threshold test in article 2, the Proxy Test in article 3.1(a) ("Proxy Test") and the Capital Employed Test in article 3.1(b) of RTS 20 assessed on a person (entity) level?

Answer: Yes, the numerator of these tests is to be applied on the person (entity) level, by each entity within the same group dealing in derivatives and not on an aggregated group level.

Reasoning:

a) Overall Market Threshold Test in article 2 RTS 20

The clear wording provides that under article 2(2), first subpara. RTS 20 the numerator is composed of the activities undertaken by "a person" within a group, i.e. the numerator is calculated on an individual person (entity) level.

b) Proxy Test in article 3.1(a) RTS 20

Again, the clear wording under the first sub-paragraph of article 3(3) RTS 20 provides that the numerator is composed of the activities undertaken by "a person" within a group, i.e. the numerator is calculated on an individual person (entity) level.

c) Capital Employed Test in article 3.1. (b) RTS 20

The Capital Employed Test is to be construed in the context of the two afore-mentioned tests. In addition, article 2(2), first subpara. RTS 20 clearly makes reference to "activities referred to in article 1 undertaken by a person", which comprises activities "in accordance with Article 3" and, consequently, extends this understanding (indirectly) also to the entire

Capital Employed Test. Hence, also the numerator to the Capital Employed Test is limited to the activities undertaken by "a person" within a group.

2. Activities undertaken "in the Union" (geographical scope)

1st Question: Are the Overall Market Threshold test in article 2, the Proxy Test in article 3.1(a) and the Capital Employed Test in article 3.1(b) of RTS 20 limited to activities undertaken "in the Union"?

Answer: Yes. Only the denominator of the Capital Employed Test and the Proxy Test are to be calculated on a world-wide group basis.

Reasoning:

a) Overall Market Threshold Test in article 2 RTS 20

The clear wording provides under article 2(2), first and second subpara. RTS 20 that this test is calculated based on activities "in the Union". Also, the trade repositories under EMIR have only data available for activities "in the Union".

b) Proxy Test in article 3.1(a) RTS 20

With respect to the numerator of the Proxy Test, the wording under the first sub-paragraph of article 3(3) RTS 20 makes a clear reference to the calculation criteria of article 2 (2) RTS 20 and, therefore, also this test is limited to activities "in the Union".

c) Capital Employed Test in article 3.1. (b) RTS 20

The numerator of the Capital Employed Test is to be construed in the context of the two afore-mentioned tests. Hence, also the numerator to the Capital Employed Test is limited to the activities undertaken "in the Union".

Only the denominator of the Capital Employed Test and of the Proxy Test are to be calculated on a world-wide group basis as article 3 (9) RTS 20 makes a reference to "the sum of the total assets of the group" and the second sub-paragraph of article 3(3) RTS 20 refers to "all contracts…to which persons within the group are party to". In recital (1) RTS 20 it is clearly stated that "In line with Article 2(11) of Directive 2013/34/EU of the European Parliament and of the Council', a group is considered to comprise the parent undertaking and all its subsidiary undertakings and includes entities domiciled in the Union and in third countries regardless of whether the group is headquartered inside or outside the Union."

2nd Question: Does the term activities undertaken "in the Union" extend to the activities of an EU established person over non-EU trading venues?

Answer: No.

Reasoning:

The term trading activities undertaken "in the Union" is defined in more detail in article 2 (3) RTS 20:

- Trading over non-EU regulated trading venues is not covered by the definition of article 2 (3), second alternative RTS 20, because it deals only with trading on venues located in the Union. A regulated market, MTF or OTF, for these purposes, is one so authorised under the MiFID II legislation and, as such, cannot include non-EU venues
- Also the first alternative of article 2 (3) RTS 20 is not applicable as it deals exclusively with bilateral OTC trading and trading over 3rd country trading venues is not bilateral OTC trading.

- In concordance with this, the recital 4, last sentence RTS 20 speaks of "contracts which are traded on and outside trading venues *in the Union*" and not of trading venues outside the Union.

3rd Question: Does the term activities undertaken "in the Union" extend to the activities of a non-EU established person when it trades over EU regulated trading venues or/and bilateral OTC with an EU established person? Does the answer differ, if the non-EU established person is part of a group established in the EU?

Answer: No (for both questions).

Reasoning: MIFID and the exemption regime and RTS 20 do apply to EU established persons only, but not to non-EU established persons. Therefore, the activities of a non-EU established person are not in scope of the Ancillary Activity Tests under RTS 20. For these reasons the activities of a non-EU established person are not to be taken into account by the affiliated group established in the EU.

3. Treatment of MiFID II Authorised Activity

Question: Should activities already authorised under MiFID I / II be deducted from the numerators and denominators of the Ancillary Activity Tests where relevant?

Answer: Yes.

Reasoning: This is explicitly stated in recital 13 ("The rationale of the ancillary activity tests is to check whether persons within a group that are not authorised in accordance with Directive 2014/65/EU should apply for an authorisation…It is therefore appropriate to calculate the size of the ancillary activity of the group by using criteria which exclude the activity carried out by group members which are authorised in accordance with that Directive in order to assess the size of genuine ancillary activity carried out by unauthorised group members .") and in articles 2 (2), second subpara. and 3 (4) RTS 20. These considerations are also applicable to the Capital Employed Test.

4. Calculation Frequency and Data Basis for Ancillary Activity Tests

Question: Should the outcomes of each of the Ancillary Activity Tests be calculated on a daily basis during the calculation period and be based on all trading days per se?

Answer: No. The RTS 20 distinguishes between the frequency of the Ancillary Activity Tests and the underlying data basis for these tests. With regard to the calculation frequency article 4 (1) RTS 20 states that these calculations "shall be carried out annually in the first quarter of the calendar year that follows an annual calculation period". Therefore, firms can calculate the Ancillary Activity Tests only once during the first quarter of a year and are not obliged to calculate these tests on a more frequent basis during the calculation periods. With regard to the data basis for this annual calculation of the Ancillary Activity Tests, firms should be allowed to consider a number of representative trading days during the calculation period as appropriate to the complexity of their business. Furthermore, firms should be allowed to use the clearing threshold calculations performed for the purpose of compliance with article 10 of EMIR also for the purpose of the calculations for the Ancillary Activity Tests.

Reasoning: RTS 20 doesn't establish a binding daily calculation frequency within a calculation period. This is because it speaks in article 4 (1) of an annual calculation to be carried out in the first quarter of the year that follows an annual calculation period. Therefore, persons may perform the calculation only once during the first quarter of year. With regard to the underlying data basis for this annual calculation, article 4 (1) RTS 20 speaks of a

calculation “based on a simple average of the daily trading activities or estimated capital”. We believe that an annual calculation based on all trading days (250 days) would impose overly burdensome calculations on MiFID II exempted firms. In particular an annual calculation of the Capital Employed Test based on positions held on all trading days would be overly burdensome as it requires complex calculations of net and gross positions. Also for such firms, which entire portfolios of privileged and non-privileged trading activities are clearly below the defined test thresholds, a calculation based on all trading days would not be meaningful and impose unnecessary burdens. Finally, a calculation based on all trading days would not be more meaningful than a calculation based on representative days, given the seasonality of certain commodity trading activity. Therefore, we are of the opinion that it is more proportionate that firms may perform the calculations of the daily trading activities or estimated capital as appropriate to the scope and complexity of their business and sufficient to provide a representative yearly notification to the competent authorities about the usage of the exemption. For these reasons we are of the opinion that the calculations can be done with an appropriate, representative granularity, i.e., based on representative trading days (e.g. for the purpose of the Capital Employed Test positions held on the last Friday of each month or each quarter). Furthermore the re-usage of EMIR clearing threshold calculations seems justified, in particular as under EMIR and MiFID II the definitions of financial instruments, hedging and intra-group transactions are the same.

5. Transitional Arrangements

Question: Given that there is an obligation to calculate the Ancillary Activity Tests until the end of the quarter of the year following the first 3 year calculation period (i.e. for the first time by end of March 2018) what transitional arrangements will be put in place to manage the period between requiring MiFID II authorisation and becoming formally MiFID II authorised?

Answer: Transitional arrangements either through changes to laws (where required) or under supervisory practice are necessary to avoid a cliff-edge effect which would have important market disruption as a consequence.

Reasoning: National regulators will be keen to ensure that there is no breach of law in respect of carrying out regulated activities when required to be authorised. As a result transitional arrangements of a reasonable period should be drafted and agreed by all national regulators to bridge the period between the end of the first 3 year calculation period (i.e. Dec 31st 2017) and the end of the period in which a firm failing an ancillary test or tests should become authorised. This transitional regime is necessary as under (some) national laws, if an entity continues to engage in MiFID II regulated activity without being MiFID II authorised despite exceeding the ancillary activity thresholds, it commits a criminal offence and any regulated activity is unenforceable. Regulators/ESMA should ensure that there is no market disruption and that a firm requiring authorisation for the first time can continue to trade between the period from 1st of January of each year through the period when it is able to do the calculations until the date when it receives its authorisation. Such an entity should be allowed to continue to trade in the meantime and should be able to rely on such transactions being valid and enforceable.

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