



Commodity Derivatives Working Group – 7th November 2016

Briefing note on MiFID II - Ancillary Activities

RTS 20 - Timeline

RTS 20 has not yet been adopted by the European Commission.

28th September 2015: ESMA publishes MiFID II [Final Report](#) and [Regulatory Technical Standards](#)

- Two trading tests :
 - 1) Trading Activity test aka Market Share Test
 - 2) Main Business Test
 - Both tests calculated at group level, calculations based on trading activity volumes.

- In this draft, ESMA moved away from the previously proposed combination of a “*minority of activities*” test and a “*size of trading activity*” test. In particular, it removed the “*capital employed*” test (= if an entity spent more than 5% of its capital on commodity trading, it would require a MiFID II licence). Instead, ESMA proposed two trading tests, which each use quantitative criteria based on trading activity volumes.

- These are the “*trading activity*” (or “*market share*”) test and the “*main business*” test. The “*trading activity*” test sets a threshold level per asset class; the “*main business*” test adjusts those thresholds in some cases. If an entity exceeds any of the resulting thresholds in any commodity class, it will **not** qualify for the ancillary business exemption.

14th March 2016: European Commission sends [letter](#) to ESMA requesting specific changes are made to RTS 20:

- Capital employed to be included as a parameter of the Main Business test; the trading ratio test proposed by ESMA does not capture the main business of the group (not in line with lvl 1).
- More cautious approach regarding thresholds in the initial years until there is sufficient data available under MiFID II.

24th March 2016: ESMA [responds](#) to EC’s proposed amendments to RTS 20, setting out their assumption that a) the EC letter was a rejection under Art. 10 (1) subparagraph 6 of Regulation (EU) 1095/2010, and b) that there are no other elements that the EC intends to amend.

20th April 2016: European Commission sends an additional [letter](#) to ESMA citing Art. 10 and officially rejecting RTS 20.



- Repeats request for the capital test to be reintroduced for big entities and for groups that have undertaken significant capital investments relative to their size in the creation of infrastructure, transportation, production of facilities and in other investments that cannot be hedged in the financial market.
- SMEs to be given the choice of employing either capital or the Main Business test.
- Capital should be measured by taking into account financial instruments and regulatory capital.

30th May 2016: ESMA publishes [opinion and annex on RTS 20](#)

- ESMA makes limited changes to RTS 20.
- ESMA has clarified that the numerator and denominator for the Trading Activity and Main Business test should be calculated based on commodity derivative trading in the EU by persons in a group.
- Treasury financing activity counted towards the definition of risk reducing transactions.
- ESMA maintains that the Main Business test is in line with lvl 1 requirements and that the reintroduction of a capital test would have significant drawbacks.
- However, ESMA does suggest some metrics, which could be used if the EC deem it necessary to introduce a capital test.
- ESMA recommends that entities should be able to choose between the Main Business test and the capital test to avoid disadvantaging SMEs.

Next steps

Once the Commission adopts and publishes RTS 20, the Parliament and Council can make use of a 3 month scrutiny period, which can be extended by a further 3 months. Following approval by the Parliament and Council, RTS 20 will be translated (estimated timeline between 1 and 2 months) before publishing the RTS in the Official Journal.

Key concerns

- **Market size data:** Will ESMA publish the market size for relevant commodity classes and when will such data be available? It is our understanding that ESMA will not publish the market size data and instead may consult on establishing an obligation for trade repositories to publish this data. Concerns regarding such obligation are that TR's hold MiFID I data, do not have EEOC data and that a consultation and subsequent rule making will take time that isn't available anymore.
- **Timeline for authorisation:** If an entity establishes that it needs to be MiFID II authorised and cannot make use of the exemptions, it will need to prepare an application for authorisation, submit such application to the FCA or other relevant competent authority and wait for the approval of the application. Between the date of the entity being aware of the fact that it requires authorisation and the date when it becomes authorised, several months (up to 1 year) can pass. Under English law, if the entity continues to trade prior to becoming authorised although it no longer qualifies for the exemption, undertaking any MiFID activity is considered



a criminal offence. In addition, transactions entered into during this timeframe are voidable. In order to avoid market disruption or the entity being forced to stop trading while its application for authorisation is prepared and processed, a transitional period is required to a) allow the entity to continue to trade in commodity derivatives and b) to provide certainty to its counterparties that transactions during such transitional period are not voidable. FIA is continuing its advocacy efforts in this area and the next step will be to liaise with Treasury to discuss either changes to English law or a transitional period providing certainty to firms.

- **Risk-reducing transactions:** Are entities able to fulfil the criteria under Q 10 of the EMIR Q&A?
- **Implementation uncertainty:** How will the authorisation process work, how will the notification that an entity is exempt from MiFID II under the ancillary activities exemption work in practice and how will the threshold need to be calculated under the proposed tests?