

ESMA provides clarity on trading obligations for derivatives under MiFID II

On 28 September 2017, the European Securities and Markets Authority (**ESMA**) published its report on the revised trading obligation regulatory technical standards (**RTS**). These help implement the trading obligations (**TO**) for the most liquid credit default swap (**CDS**) and interest rate swap (**IRS**) derivatives, to be introduced under MiFIR/MiFID II¹. The RTS supplements the existing regulations under MiFIR, and furthermore amends aspects of the European Markets Infrastructure Regulation (**EMIR**)².

What is the trading obligation?

MiFIR imposes an obligation for in-scope entities to trade a limited range of liquid derivatives that are already subject to a clearing obligation (**CO**) under EMIR³ on one of the following:

- i. a regulated market (such as the London Stock Exchange, BATS Europe and ICE Futures) – this is defined as a multilateral system operated and/or managed by a market operator, which brings together multiple third party buying and selling interests in financial instruments⁴;
- ii. a multilateral trading facility (MTF) (such as Tradeweb, Turquoise Derivatives and BATS Trading) – this is defined as a multilateral system operated by an investment firm or a market operator, which brings together multiple third party buying and selling interests in financial instruments⁵;
- iii. an organised trading facility (OTF) – a multilateral system which is not a regulated market or an MTF and in which multiple third-party buying and selling interests in bonds, structured finance products, emission allowances or derivatives are able to interact in the system in a way that results in a contract⁶; or
- iv. an equivalent third-country trading venue – which means a regulated market, MTF or an OTF which is located outside of the EU⁷.

The TO only applies to classes of derivatives that are sufficiently liquid and available for trading on at least one trading venue, and which have been mandated for trading by ESMA.

What derivatives are covered?

ESMA proposes that the following classes of derivatives be subject to the TO:

- i. fixed-to-floating IRS (covering 3 and 6m EUR EURIBOR, USD LIBOR and GBP LIBOR in a range of maturities up to 30 years); and
- ii. index CDS that are subject to the clearing obligation (iTraxx Europe Main and iTraxx Europe Crossover).

When will the trading obligation take effect?

If ESMA approves the RTS by 28 December 2017, the TO will take effect from the later of the following dates:

- i. 3 January 2018 (when the Regulation is scheduled to enter into force); or
- ii. the date from when the CO for the derivatives takes effect. As part of ESMA's proposals, the TO should start no earlier than the date of the CO.

Category 1 and 2 counterparties are already subject to the CO and therefore in theory would be subject to the TO as soon as MiFID II comes into force.

However, ESMA has acknowledged that from 3 January 2018, due to needing to make a sufficient number of equivalence determinations (that is, EU recognition of non-EU regulatory frameworks) before the TO takes effect, it would not be opposed to a short delay in the application of the TO, by no more than three months.

¹ Directive 2014/65/EU (**MIFID II**) and Regulation (EU) No 600/2014 (**MIFIR**)

² Regulation (EU) No. 648/2012 (**EMIR**)

³ Ibid, Article 28

⁴ Regulation (EU) No 600/2014, Article 2(13)

⁵ Ibid, Article 2(14); Article 4.1(57), Directive 2014/65/EU

⁶ Ibid, Article 2(15)

⁷ Ibid, Article 2(16)

Category 3 and 4 counterparties will then benefit from a phased approach as follows:

OTC derivatives class	Category of counterparty			
	Category 1	Category 3	Category 3	Category 4
IRS (EUR, GBP, USD)	Date of application of the RTS on the TO	Date of application of the RTS on the TO	21 June 2019	21 December 2018
Credit derivatives	Date of application of the RTS on the TO	Date of application of the RTS on the TO	21 June 2019	09 May 2019

A derivative is in scope if both parties are subject to the trading obligation at the time of trading, or if one party is subject to the trading obligation and its counterparty is a non-EU entity that would be in scope if it were based in the EU.

What happens next?

ESMA's report has been submitted to the European Commission (EC) for endorsement. The EC has three months to decide whether to endorse the terms suggested by ESMA or propose further amendments.

Contact details

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Appendix

Fixed-to-float single currency interest rate swaps EUR EURIBOR 3 and 6M		
Settlement currency	EUR	EUR
Trade start type	Spot (T + 2)	Spot (T + 2)
Optionality	No	No
Tenor	2, 3, 4, 5, 6, 7, 8, 9, 10, 12, 15, 20, 30Y	2, 3, 4, 5, 6, 7, 10, 15, 20, 30Y
English	Constant Notional	Constant Notional
<i>Fixed leg</i>		
Payment frequency	Annual or semi-annual	Annual or semi-annual
Day count conversion	30/360 or Actual/360	30/360 or Actual/360
<i>Floating leg</i>		
Reference index	EURIBOR 6M	EURIBOR 3M
Reset frequency	Semi-annual or quarterly	Quarterly
Day count convention	Actual / 360	Actual / 360

Fixed-to-float single currency interest rate swaps USD LIBOR 3M		
Settlement currency	USD	USD
Trade start type	Spot (T + 2)	IMM (next two IMM dates)
Optionality	No	No
Tenor	2, 3, 4, 5, 6, 7, 10, 12, 15, 20, 30Y	2, 3, 4, 5, 6, 7, 10, 12, 15, 20, 30Y
English	Constant Notional	Constant Notional
<i>Fixed leg</i>		
Payment frequency	Annual or semi-annual	Annual or semi-annual
Day count conversion	30 / 360 or Actual / 360	30 / 360 or Actual / 360
<i>Floating leg</i>		
Reference index	USD LIBOR 3M	USD LIBOR 3M
Reset frequency	Quarterly	Quarterly
Day count convention	Actual / 360	Actual / 360

Fixed-to-float single currency interest rate swaps USD LIBOR 6M		
Settlement currency	USD	USD
Trade start type	Spot (T + 2)	IMM (next two IMM dates)
Optionality	No	No
Tenor	2, 3, 4, 5, 6, 7, 10, 12, 15, 20, 30Y	2, 3, 4, 5, 6, 7, 10, 12, 15, 20, 30Y
English	Constant Notional	Constant Notional
<i>Fixed leg</i>		
Payment frequency	Annual or semi-annual	Annual or semi-annual
Day count conversion	30 / 360 or Actual / 360	30 / 360 or Actual / 360
<i>Floating leg</i>		
Reference index	USD LIBOR 6M	USD LIBOR 6M
Reset frequency	Quarterly or semi-annual	Quarterly or semi-annual
Day count convention	Actual / 360	Actual / 360

Fixed-to-float single currency interest rate swaps GBP LIBOR 3 and 6M		
Settlement currency	GBP	GBP
Trade start type	Spot (T + 0)	Spot (T + 0)
Optionality	No	No
Tenor	2, 3, 4, 5, 6, 7, 10, 15, 20, 30Y	2, 3, 4, 5, 6, 7, 10, 15, 20, 30Y
English	Constant Notional	Constant Notional
<i>Fixed leg</i>		
Payment frequency	Quarterly or semi-annual	Quarterly or semi-annual
Day count conversion	Actual / 365F	Actual / 365F
<i>Floating leg</i>		
Reference index	GBP LIBOR 6M	GBP LIBOR 3M
Reset frequency	Semi-annual or quarterly	Quarterly
Day count convention	Actual / 365F	Actual / 365F

Index credit default swaps						
Type	Sub-type	Geographical zone	Reference Index	Settlement Currency	Series	Tenor
Index CDS	Untranching Index	Europe	iTraxx Europe Main	EUR	on-the-run series first off-the-run series	5y
Index CDS	Untranching Index	Europe	iTraxx Europe Crossover	EUR	on-the-run series first off-the-run series	5y

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