MEMO# 30903

October 10, 2017

EU Adopts Rules Requiring Trading of Certain Derivatives on a Regulated Venue

[30903]

October 10, 2017 TO: ICI Members
ICI Global Members
Derivatives Markets Advisory Committee
Equity Markets Advisory Committee
ICI Global Trading & Markets Committee
Securities Operations Advisory Committee SUBJECTS: Derivatives
International/Global RE: EU Adopts Rules Requiring Trading of Certain Derivatives on a Regulated Venue

The European Securities and Markets Authority (ESMA) recently published a final report and draft regulatory technical standards (RTS) establishing a trading obligation for derivatives under the Markets in Financial Instruments Regulation (MiFIR).[1] The RTS would require certain types of interest rate and credit default swaps that are subject to the clearing obligation under the European Market Infrastructure Regulation (EMIR) to be traded on a regulated market, multilateral trading facility, organized trading facility,[2] or a third-country trading venue deemed to be equivalent by the European Commission. The RTS will become final after the European Commission, Parliament, and Council have an opportunity to review and revise them. The final draft RTS contemplate that these institutions will move quickly and the trading obligation will begin, for some counterparties, on January 3, 2018.

Overview of the Proposed New Legal Requirements

Consistent with ICI Global's recommendation, the Final Report would apply the trading obligation only to the most liquid types of derivatives—two types of index credit default swaps as well as certain fixed-float interest rate swaps denominated in euro (EUR), US dollars (USD), and British pounds (GBP).[3] To align its rules more closely with those of the Commodity Futures Trading Commission, the characteristics that will make a class of derivatives subject to the trading obligation have shifted slightly from ESMA's proposal. The appendix to this memorandum contains a complete list of the classes of derivatives that would be subject to a trading obligation under the draft RTS, and indicates changes that ESMA made from earlier draft RTS.

The Final Report provides no exemption from the trading obligation for large-size transactions or derivatives executed as part of a package trade, even though ICI Global argued that applying the trading obligation to these transactions could harm liquidity. The Final Report expresses the view that MiFIR "already provides for a sufficient degree of flexibility to execute large trades," both with respect to the various execution venues permitted under the trading obligation and the various trading protocols those execution venues can employ.[4] Moreover, the Final Report explains that ESMA lacks a mandate to develop a tailored regime for package transactions, but notes that ESMA is working on Q&As to help reduce uncertainty about the treatment of packages.[5]

Compliance Date

The draft RTS call for the trading obligation to take effect on the later of: (1) January 3, 2018 (the date that MiFIR and MiFID II take effect) or (2) the date from which the clearing obligation for derivatives take effect, as described in the table below. Although it is not clear whether this compliance schedule will hold—because the European Commission, Parliament, and Council have an opportunity to review the draft RTS—market participants may want to consider these dates to they prepare for MiFIR and MiFID II implementation.

Proposed Application Date for the Trading Obligation

OTC derivatives class

Category of counterparty[6]

Category 1

Category 2

Category 3

Category 4

Interest Rate Derivatives (EUR, GBP, USD)

Jan. 3, 2018

Jan. 3, 2018

Jun. 21, 2019

Dec. 21, 2018

Credit Derivatives

Jan. 3, 2018

Jan. 3, 2018

Jun. 21, 2019

May 9, 2019

Public Register

MiFIR requires ESMA to publish and maintain on its website a public register for the trading obligation for derivatives.[7] ESMA has determined that the register will include the following data elements:

- **For interest rate derivatives:** Type, reference index, settlement currency, settlement currency type, trade start date, optionality, tenor, notional type, fixed rate type, fixed rate payment frequency, floating rate reset frequency, and day count convention for both fixed and floating rates.
- **For credit derivatives:** Type, sub-type, geographical zone, reference index, settlement currency, application series, and tenor.[8]

ESMA also will maintain a separate register with the list of trading venues for interest rate and credit derivatives. The venue will not specify the trading venue(s) on which a particular instrument trades.

Appendix

Classes of Derivatives Subject to the Trading Obligation[9]

Fixed-to-float interest rate swaps denominated in EUR

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

Notional type

Constant notional

Constant notional

Fixed Leg

Payment Frequency

Annual or **semi-annual**

Annual or **semi-annual**

Day count convention

30/360 or Actual/360

30/360 or Actual/360

Floating Leg

Reference index

EURIBOR 6M

EURIBOR 3M

Reset frequency

Semi-annual or **quarterly**

Quarterly

Day count convention

Actual/360

Actual/360

Fixed-to-float interest rate swaps denominated in USD

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

Notional type

Constant notional

Constant notional

Fixed Leg

Payment Frequency

Annual or semi-annual

Annual or semi-annual

Day count convention

30/360 or Actual/360

30/360 or Actual/360

Floating Leg

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

Notional type

Constant notional

Constant notional

Fixed Leg

Payment Frequency

Annual or semi-annual

Annual or semi-annual

Day count convention

30/360 or Actual/360

30/360 or Actual/360

Floating Leg

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 interest rate swaps denominated in GBP

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

Notional type

Constant notional

Constant notional

Fixed Leg

Payment Frequency

Quarterly or semi-annual

Quarterly or **semi-annual**

Day count convention

Actual/365F

Actual 365/F

Floating Leg

Reference index

GBP LIBOR 6M

GBP LIBOR 3M

Reset frequency

Semi-annual or **quarterly**

Quarterly

Day count convention

Actual/365F

Actual/365F

Index CDS

Type

Sub-type

Geographical zone

Reference index

Settlement Currency

Series

Tenor

Index CDS

Untranched index

Europe

iTraxx Europe Main

EUR

on-the-run series and first off-the-run series

5y

Index CDS

Untranched index

Europe

iTraxx Europe Crossover

EUR

on-the-run series and first off-the-run series

5y

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endnotes

[1] ESMA, Final Report, Draft RTS on the trading obligation for derivatives under MiFIR (19 June 2017), *available at* https://www.esma.europa.eu/sites/default/files/library/esma70-156-227_final_report_trading_obligation_derivatives.pdf (Final Report). The Final Report follows two ESMA consultations on the trading obligation. *See* ICI Memorandum No. 30753 (June 23, 2017), *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo30753 and ICI Memorandum No. 30313 (October 14, 2016), *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo30313. ICI Global commented on both consultations. *See* ICI Memorandum No. 30808 (July 31, 2017), *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo30808 and ICI Memorandum No. 30410 (November 21, 2016), *available at* https://www.iciglobal.org/iciglobal/pubs/memos/memo30410.

[2] An organized trading facility is a type of trading venue created by Markets in Financial Instruments Directive II (MiFID II).

[3] *See* ICI Memoranda No. 30753 and 30313, *supra*, note 1 for a description of the techniques that ESMA used to assess liquidity for purposes of the trading obligation.

[4] Final Report at 8. The report also notes that trading venues can apply for waivers from pre-trade transparency requirements to prevent information leakage.

[5] Final Report at 9.

[6] ESMA distinguished four categories of counterparties for the purpose of clearing obligation:

- Category 1: Clearing members, for at least one of the classes of OTC derivatives subject to the clearing obligation, of a least one of the CCPs authorized or recognized before the date to clear at least one of those classes. Counterparties are included in

category 1 on a per asset class approach.
- Category 2: Financial counterparties and alternative investment funds (AIFs) that are not clearing members and belong to a group having at least €8 billion of average aggregate month-end notional exposure, as calculated for purposes of the clearing requirement for derivatives.
- Category 3: Financial counterparties and AIFs that are not included in Category 1 or Category 2.
- Category 4: Non-financial counterparties.

[7] *See* Article 34 of MiFIR.

[8] Final Report at 17-18.

[9] Underlined and bolded text indicates changes from the proposed trading obligation.