Summary of the first call of the CMCE Brexit Working Group (2 March 2018)

1. Status update on Brexit

The advisory team made an introduction noting the aim of establishing a Brexit WG is to provide a forum for discussion for members, while being mindful that individual members have their own contingency plans at varying stages of execution. The advisors welcome feedback and suggestions from members if there are specific issues they would like to discuss in this forum.

The advisors provided a recap of the state of the Brexit negotiations and recent developments. European Commission published the draft withdrawal agreement on Wednesday 28 February which transforms into legal provisions the principles that were agreed in December.

The expectation is that the future relationship will be based on an FTA and will therefore not include detailed provisions on financial services, the FS sector is likely to need to rely on equivalence. Questions remain as to whether and what changes will be made to the equivalence framework ahead of the UK's exit. MEPs and some member states have raised the need to have a more robust equivalence framework with a view to Brexit. The Commission has so far been piecemeal in its approach and it could be argued that the Commission does not have the political incentive to address this right now as it might be seen as making concessions to the UK.

The ESAs will be looking to revise relevant calculations under L2 measures in advance of the UK leaving the EU. The timeline depends on whether there will be an agreement on transitional arrangements, as if that is the case EU law will apply during the transitional period, so revisions could be done later in the process.

The EU wants to conclude discussions on the transitional arrangements in March, but this timeline remains uncertain. Michel Barnier wants to conclude the negotiations on the withdrawal agreement by the end of October in order to leave time for it to be ratified. The Withdrawal agreement should be accompanied by a political statement on the future relationship.

2. Possible implications of Brexit on the application of EU law

The advisory team provided a gap analysis of possible changes in the application of key pieces of EU law resulting from an exit of the UK from the EU. These observations are based on the (perhaps unlikely) assumption that the current laws do not change to take account of Brexit. How would they apply, if the UK is no longer a part of the Union?

MiFID II

Topic	**Description**
Definition of financial instrument	Certain "financial instruments" (**FIs**) under MiFID II defined by reference to the fact that they are traded on "trading venues" (**TVs**). TVs are by definition regulated markets, MTFs and OTFs *established within the Union*. Section C.6 of Annex I of MiFID II applies to certain physical forwards on TVs. Therefore, after Brexit, physical forwards on UK venues would no longer be covered by C6, but they may be within the scope of Section C.7. Similarly, the Remit definition of "wholesale energy product" (**WEP**) will no longer catch gas and power trades deliverable within the UK: NBP, GTMA and LNG trades for South Hook, for example, would all cease to be WEPs. As a result, the so-called Remit carve-out under Section C.6 will operated differently in two ways. First, UK brokers will cease to be OTFs so that no WEPs traded on their platforms would be eligible for the Remit carve-out. Second, NBP/ GTMA trades (and LNG trades for South Hook for example) would cease to WEPs and would therefore also cease to be eligible for the Remit carve-out, even if traded on a continental European OTF. For example, a TTF forward traded on a UK broker venue which is currently an OTF might currently be REMIT-exempt, but post-Brexit, it would likely fall under C.7 of Annex I of MiFID II rather than C.6. The spot emissions definition will also depend on what happens with respect to the UK's participation in or interaction with the EU Emission Trading Scheme.
Passporting	Firms based in the UK would no longer be able to benefit from the freedom to provide services or the freedom of establishment for investment firms authorised under MiFID 2. There would be no MiFID2 passport.
Ancillary Activity Exemption	As the AA exemption is framed by a reference to thresholds for market size *in the Union*, for both the numerator and denominator of the calculation, there would be a step change in both these figures. It is important to note that ESMA has previously said that trades on venues outside the Union are excluded from the market size calculation. That would mean that volumes on UK venues would begin to be excluded from the date of Brexit. UK exchanges, which are now taken into consideration within the threshold for both the numerator and denominator, will no longer be included in the threshold. That is likely to skew the figures dramatically in some markets. In particular there is a transitional step change risk. The **3-year rolling average figure could be destabilised in some cases by the change in the numerator/denominator basis.**

	There is therefore a real possibility that the EU would consider revising aspects of the regime. It is worth noting that EU firms wishing to keep their numerator low, could trade on UK venues, so as to exclude all that volume from their AA threshold calculations. If there were no change to the regime, the UK could present an attractive market place for such firms. However, much depends on the UK approach to the exemption and whether they go for a like-for-like regime or not. The EU is capable of legislating against using the UK as an avoidance destination.
Position limits	As the UK will become a third-country, the EU regime on position limits would no longer be applicable to contracts on UK venues. The FCA may choose to create its own, separate position limits regime, but they have not expressed a strong commitment to position limits.
Definition of a systematic internaliser	Detailed transparency requirements apply for firms which meets the definition of an SI, for trading OTC for a product which is "traded on trading venue". Part of the SI definition is framed as a threshold calculation, which is based on the ratio of the firms' trading activity in a given product as a proportion of the overall market in the Union. Clearly, this calculation will look different after Brexit when volumes traded in UK are not included in the assessment of the overall Union volume.
M&A rules	These rules are pan-European, and they require competent authorities to consent to changes in control within certain time-scales. The FCA would not be considered an NCA, so MiFID II timescales etc. would not apply.
Waivers/ Deferrals of Transparency	In deciding whether waivers/deferrals of transparency obligations are to be granted, MIFID2 requires the NCA to consider the liquidity of a given product. Liquidity is calculated with reference to an activity on, and data collected from TVs in the Union. In considering whether there is potential for a waiver, UK market volumes will become less relevant for a liquidity analysis for EU products.
Branch requirements under art.39	Art. 39 allows Member States to require firms to establish a branch in their jurisdictions when those firms trade with or provide services to retail clients or elective professional clients in their jurisdiction. That applies when they trade as a third-country firm: UK firms trading into Europe will have to consider for the first time this post-Brexit.
Reporting service providers	Authorised Reporting Mechanisms (ARMs) will not be able to be based in the UK after Brexit, as they will have to be authorised in their home MS i.e. where they are set up. ARMs may have to consider a Brexit relocation.

Trading obligation	The Commission can require that trading takes place on an EU TV or an equivalent third-country TV. If the mandatory trading obligation is imposed in commodities derivatives markets, compliance by EU investment firms with that obligation would require that the volume is taken off UK venues unless an equivalence decision is granted in respect of UK venues. (This would likely require retention of the position limits regime.)
Market access	The big issue is market access and eventually the framework provided under the **third-country access regime** (art. 46 and 47 of MiFIR). A UK firm, post-Brexit, trading cross-border on a venue or with a client/counterparty in an EU Member State, has two ways to do so: 1) to use an exemption (most likely the AA exemption), or 2) to argue that it is outside the territorial jurisdiction of that Member State's MiFID2 implementing law. Option 2 is possible until the transitional period provided for under article 46 expires (3 years from an equivalence decision on the UK), after which the only way in which UK firms could access the Member State would be by complying with art. 46 of MiFIR. This would mean becoming authorised in the UK and registering with ESMA as a third country firm. There is a lot of policy discussion emanating from ESMA (and also recently from the AFM) around the equivalent regime, suggesting that there is a possibility that it will be rethought. In considering lobbying imperatives, it's critical that in the equivalence debate that the UK does not undermine or try to change the overseas persons exclusion.

Comments from members:

- It was agreed that it is important to identify the "commodities only" topics where CMCE's efforts are best-placed, given that many broader issues will be aggressively pursued by the wider financial industry. Two specific issues where CMCE's involvement would make sense are the **AA exemption and the overseas persons exemption.** These are the only "commodities only" issues.

- One member commented that (ICE) On the overseas persons exclusion; the financial services industry has made this point to HMT; we'll be in good company in lobbying for the broad exemption for overseas persons to HMT. They are receptive to this, considering London's position as an international financial centre. One member of the advisory team warned that these arguments may be well-received in HMT, but DexEU may perceive this differently.

- One CMCE member commented that they have received advice from legal counsel that various EU member states (such as Germany and the Netherlands as well as Norway) are pursuing a similar approach to the overseas persons exemption, adding that for the Netherlands this extends for OTC products as well as TVs.

EMIR

Topic	Description
Definitions and terminology in EMIR	The **definitions and terminology** of EMIR often cross-references or is based on definitions and terminology in MiFID II, so some of the issues mentioned previously with respect to MiFID II are relevant for to the EMIR discussion as well. For example, the definitions of **derivatives** and **OTC derivatives** in EMIR cross-refer to and are based on the definition of "financial instruments" in MiFID II. It was noted above that the REMIT Carve-out will operate differently post-Brexit. This may cause some contracts which were excluded from being financial instruments by virtue of the REMIT Carve-out to become financial instruments (e.g. under C7 of Annex I to MIFID II). Those contracts would be derivatives under EMIR. Contracts that are not financial instruments will fall outside of the scope of EMIR.
Financial counterparties and non-financial counterparties	Generally, EMIR directly applies to financial counterparties and non-financial counterparties. Financial counterparties under EMIR include firms authorised or regulated under EU single market directives e.g. investment firms under MiFID II. Similarly, under EMIR non-financial counterparties are entities (other than FCs) which are established in the EU. Save in certain specific cases (deemed effect in the EU/ anti-avoidance) EMIR does not apply to third country entities but the obligations EU entities will face when dealing with third country entities will depend on what the status of the entity would be under EMIR if it were established in the EU (i.e. FC, NFC+ or NFC-). UK established entities will not be subject to EMIR itself directly, but will likely be directly subject to the UK's adoption of EMIR post-Brexit. These issues will affect various obligations applying to OTC derivatives including transaction reporting, clearing collateralisation and other risk mitigation requirements.
Intra-Group trades	Under the current EMIR regime, IGTs are excluded from the scope of the clearing obligation in certain circumstances and firms are able to make applications to their NCAs to exclude IGTs from the collateral obligations. The conditions for that exemption will change when the UK becomes a third-country. For example, where there is an EU and a UK entity, when the UK becomes a third-country, there will need to be an equivalence decision for the UK in order for NFCs to avail of this exemption.
Reporting obligations	The reporting obligation for derivatives applies to NFCs and FCs at present. As noted above, EU firms, in dealing with UK firms, will continue to be subject to this obligation and they will need to comply. Under the EMIR Refit proposal, there is an intention to change the responsibility for reporting. Right now, the obligations lay with both parties

	but going forwards, where an FC deals with an NFC, it is likely that it will be the financial counterparty which is responsible for reporting. There are also questions as to how delegated reporting would work if one party is in the UK and another is in the EU.
Obligations for CCPs	As CCPs must be either authorised in the EU, or recognised as non-EU CCPs. If not authorised or recognised, there would be a prohibition for dealing with EU clients or EU TVs. Under the **EMIR 2.2** proposals changes are being discussed to this regime. Firstly, to amend the regime for EU Based CCPs to give the ECB and ESMA, a greater role as opposed to that of NCAs. Secondly, there is also a plan to change the recognition regime to apply tighter requirements for systemically important CCPs. This is driven by Brexit for UK CCPs and the potential systemic impact that UK CCPs might have on the EU market.

BMR

The impact of Brexit on BMR will depend upon the UK approach to its home regulatory regime. The UK is capable of gold-plating, as that has been its approach to date.

Topic	**Description**
Recognition and endorsement of third-country benchmark administrators	The requirements for third-country administrators under BMR would mean that a UK administrator wishing to enable EU supervised entities to "use" its benchmarks, would need to assess their approach to the third country benchmark regime under BMR. (There are three routes currently provided for: "equivalence", "recognition" and "endorsement".) For recognition, they would need to determine the "Member State of reference." The detailed elements of this definition would apply diffrently with the UK no longer being a Member State.
Art.19 – commodities benchmarks	Some commodity benchmarks are subject to Annex 2 of BMR, which provides for a lighter touch regime for administrators and contributers. One of the conditions for this regime to apply is that *the majority of contributors are supervised entities.* A "supervised entity" for these purposes is broadly a firm authorised under an EU single market directive, like a MiFID2 investment firm or a credit institution. It would not include a UK authorised firm, post-Brexit. This may mean that some benchmarks which are currently not eligible for Annex 2 treatment could become so, if their supervised entity contributors materially comprise UK authorised firms. As these benchmarks might be populated with non-supervised entities after Brexit, they might be put into the lighter annex 2 regime.
Critical benchmarks	The definition of a critical benchmark requires the calculation of the impact of, or the usage of, that benchmark across the EU.

	A Member State can also decide whether a benchmark is critical by reference to market disruption in markets relevant to it. As the UK will not be a Member State this aspect of the criticality definition would not apply in this respect.

There was a discussion with members:

- It was decided that the implications of Brexit would be discussed for each CMCE Working Group.
- One CMCE member expressed concern that the real impact of Brexit would remain unclear until a late stage and that this would make engaging the right people in government difficult in terms of attracting their attention to commodities.
    - One member of the advisory team responded that the Ancillary exemption is one area where the UK government will focus on. The UK is very likely to gain equivalence under EMIR but it is unclear as to how the UK will adjust its approach. One CMCE member confirmed that they are aware that HMT and the FCA have AA on its radar.
- A call of the MiFID II WG will be set up to discuss possible CMCE action in relation to the points discussed in this area.