CMCE Brexit update: Relevant highlights from the UK EU Exit Statutory Instruments onshoring MAR, MiFID II and EMIR including draft SIs

Please note that all references to article numbers are to articles in the relevant UK SIs and draft SIs, unless explicitly mentioned otherwise.

For simplicity we refer to (a) "UK MAR", "UK MIFIR" and "UK EMIR" etc to mean those regulations as onshored under the EU Withdrawal Act and (b) to "EU MAR", "EU MiFIR" and "EU EMIR" etc to refer to the current versions of those regulations under EU law.

1. MAR (The Draft Market Abuse (Amendment) (EU Exit) Regulations 2018)

- Art 12(1) on **public disclosure of inside information**: This amends the disclosure regime for "issuers of financial instruments" and "emission allowance market participants" currently under article 17(1) and (2) of EU MAR.
  - Unlike under EU MAR, the draft SI includes "emission allowance market participants registered in the United Kingdom" within the scope of the more stringent disclosure regime for issuers of financial instruments under article 17(1) of UK MAR. (It also includes them in scope of the regime under article 17(2) of UK MAR.)
  - This looks like a drafting error, which should be pointed out to HM Treasury. Otherwise it may impose new disclosure obligations on some participants.
- Art 9(2) on **Scope**: This sets the scope of UK MAR. HM Treasury's intention appears to be to keep the scope broadly the same as under EU MAR.
  - As a result the draft SI applies UK MAR by reference to financial instruments on not only UK regulated markets, UK MTFs and UK OTFs, but also EU regulated markets, EU MTFs and EU OTFs. So that FCA would have market abuse powers in respect of conduct in markets relating to, e.g. PowerNext or EEX.
  - This gives rise to a clear double jeopardy risk in respect of conduct relating to EU markets.
- **Emission auctions**: The draft SI applies UK MAR in respect of auctions in emission allowances (as a general concept); whereas EU MAR applies it in respect of such auctions under the EU Auctioning Regulation. (We expect this may not have much impact in practice.)
- **ESMA guidelines**: In several instances under EU MAR, ESMA is required to develop guidelines. In the UK draft SI, this approach is not copied over and no obligation is included for the FCA to develop guidelines. No doubt this is deliberate (as FCA will wish to choose when and how to give guidance). This could potentially lead to a guidance gap, given that the onshoring of retained EU law does not include ESMA guidance.

- **Suspicious transactions and orders (STORs)**: Because UK MAR covers EU markets as well as UK markets, the STOR and surveillance and monitoring obligations under UK MAR will continue to apply to activities in financial instruments in UK and EU markets.

2. MiFID2/MiFIR (Markets in Financial Instruments (Amendment) (EU Exit) Regulations 2018/1403)

- Art 26 (amending articles 2(1)(13) to – (16B) of the UK MiFI Regs) on **definitions of trading venues**: This creates 3 versions of each type of trading venue definition to be in the UK MiFID regulations. There are:
  - conceptual definitions of "regulated market", "MTF", "OTF" and "trading venue", which are not limited by geography;
  - UK versions: "UK regulated market", "UK MTF", "UK OTF" and "UK trading venue", and
  - EU versions: "EU regulated market", EU MTF, EU OTF and EU trading venue.
- Art 26 (amending articles 2(1)(12) to (12a) of the UK MiFI Regs) on **definition of systematic internaliser (SI)**: There is a potential change of scope to the definition of SI, for two reasons:
  - The UK definition refers to "an investment firm … executing client orders outside a *UK* regulated market, *UK* MTF or *UK* OTF"; the EU MiFID2 definition covers activity outside *EU* trading venues. On the UK definition, a firm which executes only on trading venues in the UK and EU would be capable of being an SI, whereas that is not the case under the EU MiFID2 definition.
  - For the SI threshold calculations "the substantial basis" is to be measured by reference to activity in the "**relevant area"** (within the meaning of Article 14(5A)) in a specific financial instrument". Under Art 14(5A) it is left up to the FCA to define what the "relevant area" is from time to time. This gives FCA the ability to apply a different geographic scope for each product category. That might over time diverge from the expected UK + EU27 starting point.
- Art 4 on **definition of financial instruments**: In changes to sections C6 and C7 of Annex I of MiFID II to onshore them to UK law, HM Treasury has attempted to replicate the C6 REMIT carve out in the UK draft SI. However, a mistake has been made in the SI to the effect that the exemption provided is actually wider than it would currently be (in that all wholesale energy products on an EU OTF are excluded, rather than just those which "must be physically settled".
  - The FCA and HM Treasury are aware of this mistake and we understand from the FCA that it will be rectified by a later "mop-up SI" which will pick up this and other errors identified.
  - There is, however, what looks like a deliberate change to the scope of C7, at article 4(1)(4)(c) (amending article 7 of Part 2 of Schedule 2 to the RAO). This ties the second and third limbs of the "equivalence test" for C7 products by reference to equivalence with UK trading venues rather than equivalence with EU trading venues. (In practice we do not expect this to make a material difference on "day one".)

- **Ancillary activity notification**: There seems to be a discrepancy in practice in the timing for making ancillary notifications. FCA requires notifications by 3 January, while many EU27 NCAs are asking for these to be submitted by the end of Q1. (This observation does not derive from the UK SI.)

3. EMIR (The Draft Over the Counter Derivatives, Central Counterparties and Trade Repositories (Amendment, etc., and Transitional Provision) (EU Exit) Regulations 2018)

- Art 11(4) (amending article 2(4) of EU EMIR) on the **definition of "trading venue"**: The UK EMIR definition is limited to "UK trading venues" (whereas EU EMIR applies it to all trading venues including EU trading venues).
- Art 11(6) (amending article 2(6) of EU EMIR) on the **definition of "OTC derivative"**:
  - EU EMIR defines "OTC derivative" as derivatives executed outside "regulated markets" or third country markets, which have been subject to an equivalence determination by the Commission.
  - UK EMIR defines "OTC derivative" by reference to derivatives executed outside "UK regulated markets" or third country market which are either (a) subject to an EU Commission equivalence determination made before "exit day" or (b) subject to an equivalence determination by HM Treasury made after "exit day".
  - In other words, trades on EU regulated markets will be OTC derivatives unless HM Treasury makes the relevant equivalence determination. If HMT were to delay making this ruling, firms would need to take EU regulated market activity into account in their clearing threshold calculations for UK EMIR and may be subject to OTC margining obligations under UK EMIR in respect of them so it is important there is no such delay.
- Art 11(7) on **definition of financial counterparty**: The definition is transformed into UK equivalents of what the definition covers in EU EMIR, i.e. credit institutions, investment firms etc. become UK credit institutions, UK investment firms etc. This may require firms to redo their mapping of counterparty combinations in order to determine the application and effect of the UK EMIR risk mitigation requirements and clearing/margining requirements. (EU FCs and NFC+ would be TC+ under UK EMIR.)
- Art 13 on **intra-group transaction exemptions("IGTs")**: "Intra-group transactions" are eligible for exemptions from OTC margining and clearing obligations under EMIR.
  - Under EU EMIR "IGTs" with third country entities are eligible only where the third country in question has been the subject of an equivalence determination by the Commission.
  - Under UK EMIR, EU Member States are treated as third countries, so that they too will need an equivalence determination (by HM Treasury).
  - However, Part 5 of the draft UK SI, provides for transitional relief (the "Temporary Intragroup Exemption Regime") which should enable firms which are currently relying on IGT exemptions for trades with EU or third country group companies, to continue to do so (for 3 years from exit day).

- Art 19 on the **reporting obligation**: The obligation can be suspended by the FCA by up to one year, subject to HMT approval. This timeline can be extended by HMT. However, a backloading obligation would apply to reports of transactions during that time.
- Art 59(8) on the **transitional regime for C6 energy derivatives**: The definition of C6 energy derivative is not the same as under EU EMIR in that it refers only to coal and oil contracts traded on *UK* OTFs (as opposed to those traded on "UK OTFs or EU OTFs"). This implies that contracts traded on EU OTFs would not benefit from the transitional exemption from EMIR clearing and risk mitigation obligations until 2021.