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Commission Delegated Regulation (EU) 2017/592 of 1 December 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) 2017/592

of 1 December 2016

supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards for the criteria to establish when an activity is considered to be ancillary to the main business

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments[(1)], and in particular Article 2(4) thereof,

Whereas:

(1) The assessment whether persons are dealing on own account or are providing investment services in commodity derivatives, emission allowances and derivatives thereof in the Union as an activity ancillary to their main business should be performed at a group level. In line with Article 2(11) of Directive 2013/34/EU of the European Parliament and of the Council[(2)], a group is considered to comprise the parent undertaking and all its subsidiary undertakings and includes entities domiciled in the Union and in third countries regardless of whether the group is headquartered inside or outside the Union.

(2) The assessment should be performed in the form of two tests, which are both based on the trading activity of the persons within the group and should be calculated on a per-asset-class basis. The first test should determine whether the persons within the group are large participants relative to the size of the financial market in that asset class and as a consequence should be required to obtain authorisation as an investment firm. The second test should determine whether the persons within the group trade on own account or provide investment services in commodity derivatives, emission allowances or derivatives thereof to such a large extent relative to the main business of the group that those activities cannot be considered to be ancillary at group level and that therefore the persons should be required to obtain authorisation as an investment firm.

(3) The first test compares the size of a person's trading activity against the overall trading activity in the Union on an asset class basis to determine that person's market share. The size of the trading activity should be determined by deducting the sum of the volume of the transactions for the purposes of intra-group liquidity or risk management purposes, objectively measurable reduction of risks directly relating to commercial or treasury

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financing activity or fulfilling obligations to provide liquidity on a trading venue ('privileged transactions') from the volume of the overall trading activity undertaken by the person.

(4) The volume of the trading activity should be determined by the gross notional value of contracts in commodity derivatives, emission allowances and derivatives thereof on the basis of a rolling average of the preceding three annual periods. The overall market size should be determined on the basis of trading activity undertaken in the Union in relation to each asset class for which the exemption is sought, including contracts which are traded on and outside trading venues in the Union.

(5) As commodity markets differ significantly in terms of size, number of market participants, level of liquidity and other characteristics, different thresholds shall apply for different asset classes in relation to the test on the size of the trading activity.

(6) The second test provides two methods for determining the size of the trading activity in order to compare it to the size of the main activity undertaken by the group. That test takes two forms in order to better reflect the underlying activities of the persons intending to use the exemption whilst minimising the regulatory burden and complexity of implementing the test. The capital test is provided as an alternative to the trading test in order to take into account of the economic reality of the very heterogeneous groups that need to undertake the assessment whether their trading is ancillary to their main business activities, including groups that undertake significant capital investments, relative to their size, in the creation of infrastructure transportation and production facilities, as well as investments which cannot be easily hedged in financial markets. As both forms of the second test cater for the different underlying economic realities of various groups both tests constitute equally suitable methods to determine whether the trading activity is ancillary to the main business of a particular group.

(7) The size of the trading activity as used under the first method of the second test is taken as a proxy for the commercial activity that the person or group engages in as its main business. This proxy should be easy and cost efficient for persons to apply as it builds on data already required to be collected for the first test while at the same time establishing a meaningful test.

(8) This proxy is appropriate because a rational risk-averse entity, such as a producer, processor or consumer of commodities or emission allowances, is deemed to hedge the volume of the commercial activity of its main business with an equivalent volume of commodity derivatives, emission allowances or derivatives thereof. Therefore the volume of all its trading activity in commodity derivatives, emission allowances or derivatives thereof measured in the gross notional value of the underlying is an appropriate proxy for the size of the main business of the group. As groups whose main business activities are not related to commodities or emission allowances would not use commodity or emission allowances derivatives as a risk-reducing tool, their trading in commodity derivatives, emission allowances or derivatives thereof would not qualify as hedging.

(9) The use of commodity derivatives as a risk-reducing tool however cannot be considered a perfect proxy for all the commercial activity that the person or group conducts as

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its main business since it may not take into account other investments in fixed assets unrelated to derivative markets. In order to correct the potential mismatch between a group's trading in commodity derivatives and the actual size of its main business with regard, in particular, to small groups the first method of the second test should contain a backstop which recognises that the trading activity undertaken by the persons within the group should also not exceed a certain percentage of any of the thresholds set under the first test for each relevant asset class to be deemed ancillary. The higher the percentage of speculative activity within all trading activity of a group, the lower the threshold set under the first test.

(10) The backstop based on a group not exceeding a certain percentage of any of the thresholds set under the first test for each relevant asset class is particularly relevant for very small groups with negligible overall footprint in the relevant commodity derivative trading. On the one hand, those groups may be required to undertake a costly analysis of their trading activities to determine whether that trading reduces risk or not without the result being conclusive on the ancillary nature of the trading activity. On the other hand, those groups are usually not equipped to engage in the capital test as an alternative to the test based on trading. In order to avoid disproportionate burdens on those groups, it is appropriate that groups whose trading activity for each relevant asset class accounts for less than one-fifth of the threshold set under the first test be considered as carrying out that trading as an ancillary activity to their main business. The first method under the second test, however, may not adequately measure the main activity of persons who have significant capital investments, relative to their size, in the creation of infrastructure, transportation and production facilities. Neither does it recognise investments which cannot be hedged in financial markets. Therefore it is necessary for the second test to contain a second method that uses a capital based metric to measure that that trading activity is ancillary to the main business of the group.

(11) The second method under the second test uses the estimated capital that a non-financial group would be required to hold against the market risk inherent in its positions arising from trading in commodity derivatives, emission allowances and derivatives thereof, other than those from privileged transactions, as a proxy for the amount of ancillary activities undertaken by the persons in a group. The framework developed under the auspices of the Basel Committee and implemented in the Union through the Capital Requirements Directive is used to apply a proportionate notional capital weighting to positions. Within this framework, the net position in a commodity derivative, emission allowance or derivative thereof shall be determined by netting long and short positions in a particular type of commodity derivative contract, emission allowance or derivative contract thereof, such as a future, option, forward or warrants. In determining the net position, netting should take place irrespective of where the contract is traded, the contract's counterparty or its maturity. The gross position in a relevant commodity derivative, emission allowance contract or a derivative contract thereof should, on the other hand, be calculated by adding the net positions of types of contracts that relate to a particular commodity or, emission allowance or derivative thereof. In this context, net positons in a particular type of commodity derivative contract, emission allowance contract or derivative contract thereof should not be netted against each other.

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(12) Under the second method of the second test, the amount of the estimated capital of a group is then compared to the actual amount of capital employed of that group that should reflect the size of its main activity. The capital employed is calculated on the basis of the total assets of the group minus its current debt. Current debt should comprise debt that is due to be settled within 12 months.

(13) The rationale of the ancillary activity tests is to check whether persons within a group that are not authorised in accordance with Directive 2014/65/EU should apply for an authorisation due to the relative or absolute size of their activity in commodity derivatives, emission allowances and derivatives thereof. The ancillary activity tests thus determine the size of activities in commodity derivatives, emission allowances and derivatives thereof which persons within a group may carry out without authorisation under Directive 2014/65/EU due to those activities being ancillary to the group's main business. It is therefore appropriate to calculate the size of the ancillary activity of the group by using criteria which exclude the activity carried out by group members which are authorised in accordance with that Directive in order to assess the size of genuine ancillary activity carried out by unauthorised group members.

(14) In order to allow for market participants to plan and operate their business in a reasonable way and to take into account seasonal patterns of activity, the calculation of the tests determining when an activity is considered to be ancillary to the main business should be based on a period of three years. Therefore, entities should perform the assessment whether they breach one of the two thresholds on an annual basis by calculating a simple average of three years on a rolling basis in order to be able to submit their annual notification to the competent authority. This obligation should be without prejudice to the right of the competent authority to request at any time a report from a person about the basis on which that person considers its activity under points (i) and (ii) of Article 2(1)(j) of Directive 2014/65/EU to be ancillary to its main business.

(15) Transactions objectively measurable as reducing risks directly relating to commercial activity or treasury financing activity and intra-group transactions should be considered in a way consistent with Regulation (EU) No 648/2012 of the European Parliament and of the Council[(3)]. However, in relation to transactions in derivatives which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity Commission Delegated Regulation (EU) No 149/2013[(4)] only refers to derivatives not traded on regulated markets while Article 2(4) of Directive 2014/65/EU covers derivatives traded on trading venues. Therefore, this Regulation should also take into account derivatives traded on regulated markets in relation to transactions that are deemed to be objectively measurable as reducing risks directly related to commercial or treasury financing activity.

(16) In some circumstances, it may not be possible to hedge a commercial risk by using a directly related commodity derivative contract: a contract with exactly the same underlying and settlement date as the risk being covered. In such case, the person may use proxy hedging through a closely correlated instrument to cover its exposure such as an instrument with a different but very close underlying in terms of economic behaviour. Additionally, macro or portfolio hedging may be used by persons, which

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enter into commodity derivative contracts to hedge a risk in relation to their overall risks or the overall risks of the group. Those macro, portfolio or proxy hedging commodity derivative contracts may constitute hedging for the purpose of this Regulation.

(17) When a person applying the ancillary activity test uses portfolio or macro hedging, it may not be able to establish a one-to-one link between a specific transaction in a commodity derivative and a specific risk directly related to the commercial and treasury financing activities entered into to hedge it. The risks directly related to the commercial and treasury financing activities may be of a complex nature e.g. several geographic markets, several products, time horizons or entities. The portfolio of commodity derivative contracts entered into to mitigate those risks may derive from complex risk management systems. In such cases the risk management systems should prevent non-hedging transactions from being categorised as hedging and provide for a sufficiently disaggregate view of the hedging portfolio so that speculative components are identified and counted towards the thresholds. Positions should not qualify as reducing risks related to commercial activity solely on the grounds that they form part of a risk-reducing portfolio on an overall basis.

(18) A risk may evolve over time and, in order to adapt to the evolution of the risk, commodity or emission allowance derivatives initially executed for reducing risk related to commercial activity, may have to be offset through the use of additional commodity or emission allowance derivative contracts. As a result, hedging of a risk may be achieved by a combination of commodity or emission allowance derivative contracts including offsetting commodity derivative contracts that close out those commodity derivative contracts that have become unrelated to the commercial risk. Additionally the evolution of a risk that has been addressed by the entering into of a position in a commodity or emission allowance derivative for the purpose of reducing that risk should not subsequently give rise to the re-evaluation of that position as being not a privileged transaction ab initio.

(19) This Regulation is based on the draft regulatory technical standards submitted by the European Securities and Markets Authority (ESMA) to the Commission.

(20) ESMA has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Securities and Markets Stakeholder Group established by Article 37 of Regulation (EU) No 1095/2010 of the European Parliament and of the Council[(5)].

(21) For reasons of consistency and in order to ensure the smooth functioning of the financial markets, it is necessary that the provisions laid down in this Regulation and the related national provisions transposing Directive 2014/65/EU apply from the same date,

HAS ADOPTED THIS REGULATION: