Changes to legislation: *There are outstanding changes not yet made to Commission Delegated Regulation (EU) 2017/579. Any changes that have already been made to the legislation appear in the content and are referenced with annotations. (See end of Document for details)EUR 2017 No. 579 may be subject to amendment by EU Exit Instruments made by the Financial Conduct Authority under powers set out in The Financial Regulators' Powers (Technical Standards etc.) (Amendment etc.) (EU Exit) Regulations 2018 (S.I. 2018/1115), regs. 2, 3, Sch. Pt. 1. These amendments are not currently available on legislation.gov.uk. Details of relevant amending instruments can be found on their website/s. (See end of Document for details) View outstanding changes*

Commission Delegated Regulation (EU) 2017/579 of 13 June 2016 supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the direct, substantial and foreseeable effect of derivative contracts within the Union and the prevention of the evasion of rules and obligations (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) 2017/579

of 13 June 2016

supplementing Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments with regard to regulatory technical standards on the direct, substantial and foreseeable effect of derivative contracts within the Union and the prevention of the evasion of rules and obligations

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

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

Having regard to Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012[(1)], and in particular Article 28(5) thereof,

Whereas:

(1) Given the broad variety of over-the-counter (OTC) derivative contracts, in order to determine when an OTC derivative contract may be considered to have a direct, substantial and foreseeable effect within the Union as set out in Article 28(2) of Regulation (EU) No 600/2014 and to specify cases where it is necessary or appropriate to prevent the evasion of rules and obligations arising from any provision of Regulation (EU) No 648/2012 of the European Parliament and the Council[(2)], a criteria-based approach should be adopted.

(2) Article 33(3) of Regulation (EU) No 600/2014 states that the conditions laid down in Articles 28 and 29 of that Regulation are deemed to be fulfilled when at least one of the counterparties is established in a country for which the Commission has adopted an implementing act declaring equivalence in accordance with Article 33(2) of Regulation (EU) No 600/2014. The present regulatory technical standards should therefore also apply to contracts where both counterparties are established in a third country whose legal, supervisory and enforcement arrangements have not yet been declared equivalent to the requirements laid down in that Regulation.

(3) Certain information on contracts concluded by third country entities would still only be available to third country competent authorities. Therefore Union competent authorities should closely cooperate with those third country competent authorities in order to ensure that the relevant provisions are applied and enforced.

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(4) Given the intrinsic relationship between this Regulation and Commission Delegated Regulation (EU) No 285/2014[(3)], the technical terms necessary for a comprehensive understanding of the technical standards should have the same meaning.

(5) OTC derivative contracts concluded by entities established in third countries covered by a guarantee provided by entities established in the Union create a financial risk for the guarantor established in the Union. Given that the risk would depend on the size of the guarantee granted by financial counterparties in order to cover OTC derivative contracts and given the interconnections between financial counterparties compared to non-financial counterparties, only OTC derivative contracts concluded by entities established in third countries that are covered by a guarantee which exceeds certain quantitative thresholds and is provided by financial counterparties established in the Union should be considered as having a direct, substantial and foreseeable effect in the Union.

(6) Financial counterparties established in third countries can enter into OTC derivative contracts through their Union branches. Given the impact of the activity of those branches on the Union market, OTC derivative contracts concluded between those Union branches should be considered to have a direct, substantial and foreseeable effect within the Union.

(7) OTC derivative contracts that are entered into by specific counterparties with the primary purpose of avoiding the application of the trading obligation applicable to entities that would have been the natural counterparties to the contract, should be considered as evading the rules and obligations laid down in Regulation (EU) No 600/2014 as they hinder the achievement of one of the purposes of that Regulation.

(8) OTC derivative contracts that are part of an arrangement whose characteristics are not supported by a business rationale or commercial substance and have as their primary purpose the circumvention of the application of Regulation (EU) No 600/2014, including rules relating to the conditions of an exemption, should be considered as evading the rules and obligations laid down in that Regulation.

(9) Situations where the individual components of the arrangement are inconsistent with the legal substance of the arrangement as a whole, where the arrangement is carried out in a manner which would not ordinarily be used in what is expected to be reasonable business conduct, where the arrangement or series of arrangements includes elements that have the effect of offsetting or nullifying their reciprocal economic substance, where transactions are circular in nature, should be considered as indicators of an artificial arrangement or an artificial series of arrangements.

(10) Given that third country entities affected by these regulatory technical standards require time in order to arrange for compliance with the requirements of Regulation (EU) No 600/2014 when their OTC derivative contracts fulfil the conditions set out in these regulatory technical standards for being considered to have a direct, substantial and foreseeable effect within the Union, it is appropriate to delay the application of the provision containing those conditions by six months.

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(11) 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 provisions laid down in Regulation (EU) No 600/2014 apply from the same date.

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

(13) 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[(4)],

HAS ADOPTED THIS REGULATION:

Article 1

Definitions

For the purposes of this Regulation the following definition shall apply:

'guarantee' means an explicitly documented legal obligation by a guarantor to cover payments of the amounts due or that may become due pursuant to the OTC derivative contracts covered by that guarantee and entered into by the guaranteed entity in favour of the beneficiary where there is a default as defined in the guarantee or where no payment has been effected by the guaranteed entity.

Article 2

Contracts with a direct, substantial and foreseeable effect within the Union

1 An OTC derivative contract shall be considered as having a direct, substantial and foreseeable effect within the Union when at least one third country entity benefits from a guarantee provided by a financial counterparty established in the Union which covers all or part of its liability resulting from that OTC derivative contract, to the extent that the guarantee meets both following conditions:

a it covers the entire liability of a third country entity resulting from one or more OTC derivative contracts for an aggregated notional amount of at least EUR 8 billion or the equivalent amount in the relevant foreign currency, or it covers only a part of the liability of a third country entity resulting from one or more OTC derivative contracts for an aggregated notional amount of at least EUR 8 billion or the equivalent amount in the relevant foreign currency divided by the percentage of the liability covered;

b it is at least equal to 5 per cent of the sum of current exposures, as defined in Article 272(17) of Regulation (EU) No 575/2013 of the European Parliament and of the Council[(5)], in OTC derivative contracts of the financial counterparty established in the Union issuing the guarantee.

2 When the guarantee is issued for a maximum amount which is below the threshold set out in paragraph 1(a), the contracts covered by that guarantee shall not be considered to have a direct, substantial and foreseeable effect within the Union unless the amount of the guarantee is increased, in which case the direct, substantial and foreseeable effect of the contracts within