Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (Text with EEA relevance)

COMMISSION DELEGATED REGULATION (EU) 2017/565

of 25 April 2016

supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

(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 and amending Directive 2002/92/EC and Directive 2011/61/EU[(1)], and in particular Article 2(3), the second subparagraph of Article 4(1)(2), and Articles 4(2), 16(12), 23(4), 24(13), 25(8), 27(9), 28(3), 30(5), 31(4), 32(4), 33(8), 52(4), 54(4), 58(6), 64(7), 65(7) and 79(8) thereof,

Whereas:

(1) Directive 2014/65/EU establishes the framework for a regulatory regime for financial markets in the Union, governing operating conditions relating to the performance by investment firms of investment services and, where appropriate, ancillary services and investment activities; organisational requirements for investment firms performing such services and activities, for regulated markets and data reporting services providers; reporting requirements in respect of transactions in financial instruments; position limits and position management controls in commodity derivatives; transparency requirements in respect of transactions in financial instruments.

(2) Directive 2014/65/EU empowers the Commission to adopt a number of delegated acts. It is important that all the detailed supplementing rules regarding the authorisation, ongoing operation, market transparency and integrity, which are inextricably-linked aspects inherent to the taking up and pursuit of the services and activities covered by Directive 2014/65/EU, begin to apply at the same time as Directive 2014/65/EU so that the new requirements can operate effectively. To ensure coherence and to facilitate a comprehensive view and compact access to the provisions by persons subject to those obligations as well as by investors, it is desirable to include the delegated acts related to the above-mentioned rules in this Regulation.

(3) It is necessary to further specify the criteria to determine under what circumstances contracts in relation to wholesale energy products must be physically settled for the purposes of the limitation of scope set out in Section C(6) of Annex I to Directive

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2014/65/EU. In order to ensure that the scope of this exemption is limited to avoid loopholes it is necessary that such contracts require that both buyer and seller should have proportionate arrangements in place to make or receive delivery of the underlying commodity upon the expiry of the contract. In order to avoid loopholes in case of balancing agreements with the Transmission System Operator in the areas of electricity and gas, such balancing arrangements should only be considered as a proportionate arrangement if the parties to the arrangement have the obligation to physically deliver electricity or gas. Contracts should also establish clear obligations for physical delivery which cannot be offset whilst recognising that forms of operational netting as defined in Regulation (EU) No 1227/2011 of the European Parliament and of the Council[(2)] or national law should not considered as offsetting. Contracts which must be physically settled should be permitted to deliver in a variety of methods however all methods should involve a form of transfer of right of an ownership nature of the relevant underlying commodity or a relevant quantity thereof.

(4) In order to clarify when a contract in relation to wholesale energy product must be physically settled, it is necessary to further specify when certain circumstances such as force majeure or bona fide inability to settle provisions are present, and which should not alter the characterisation of those contracts as 'must be physically settled'. It is important to also clarify how oil and coal energy derivatives should be understood for the purposes of Section C(6) of Annex I to Directive 2014/65/EU. In this context, contracts related to oil shale should not be understood to be coal energy derivatives.

(5) A derivative contract should only be considered to be a financial instrument under Section C(7) of Annex I to Directive 2014/65/EU if it relates to a commodity and meets a set of criteria for determining whether a contract should be considered as having the characteristics of other derivative financial instruments and as not being for commercial purposes. This should include contracts which are standardised and traded on venues, or contracts equivalent thereof where all the terms of such contracts are equivalent to contracts traded on venues. In this case, terms of these contracts should also be understood to include provisions such as quality of the commodity or place of delivery.

(6) In order to provide clarity on the definitions of contracts relating to underlying variables set out in Section C(10) of Directive 2014/65/EU, criteria should be provided relating to their terms and underlying variables in those contracts. The inclusion of actuarial statistics in the list of underlyings should not be understood as extending the scope of those contracts to insurance and reinsurance.

(7) Directive 2014/65/EU establishes the general framework for a regulatory regime for financial markets in the Union, setting out in Section C of Annex I the list of financial instruments covered. Section C(4) of Annex I to Directive 2014/65/EU includes financial instruments relating to a currency which are therefore under the scope of this Directive.

(8) In order to ensure the uniform application of Directive 2014/65/EU, it is necessary to clarify the definitions laid down in Section C(4) of Annex I to Directive 2014/65/EU for other derivative contracts relating to currencies and to clarify that spot contracts

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relating to currencies are not other derivative instruments for the purposes of Section C(4) of Annex I to Directive 2014/65/EU.

(9) The settlement period for a spot contract is generally accepted in most main currencies as taking place within 2 days or less, but where this is not market practice it is necessary to make provision to allow settlement to take place in accordance with normal market practice. In such cases, physical settlement does not require the use of paper money and can include electronic settlement.

(10) Foreign exchange contracts may also be used for the purpose of effecting payment and those contracts should not be considered financial instruments provided they are not traded on a trading venue. Therefore it is appropriate to consider as spot contracts those foreign exchange contracts that are used to effect payment for financial instruments where the settlement period for those contracts is more than 2 trading days and less than 5 trading days. It is also appropriate to consider as means of payments those foreign exchange contracts that are entered into for the purpose of achieving certainty about the level of payments for goods, services and real investment. This will result in excluding from the definition of financial instruments foreign exchange contracts entered into by non-financial firms receiving payments in foreign currency for exports of identifiable goods and services and non-financial firms making payments in foreign currency to import specific goods and services.

(11) Payment netting is essential to the effective and efficient operation of currency settlement systems and therefore the classification of a foreign currency contract as a spot transaction should not require that each foreign currency spot contract is settled independently.

(12) Non deliverable forwards are contracts for the difference between an exchange rate agreed before and the actual spot rate at maturity and therefore should not be considered to be spot contracts, regardless of their settlement period.

(13) A contract for the exchange of one currency against another currency should be understood as relating to a direct and unconditional exchange of those currencies. In the case of a contract with multiple exchanges, each exchange should be considered separately. However an option or a swap on a currency should not be considered a contract for the sale or exchange of a currency and therefore could not constitute either a spot contract or means of payment regardless of the duration of the swap or option and regardless of whether it is traded on a trading venue or not.

(14) Advice about financial instruments addressed to the general public should not be considered as a personal recommendation for the purposes of the definition of ‘investment advice’ in Directive 2014/65/EU. In view of the growing number of intermediaries providing personal recommendations through the use of distribution channels, it should be clarified that a recommendation issued, even exclusively, through distribution channels, such as internet, could qualify as a personal recommendation. Therefore, situations in which, for instance, email correspondence is used to provide personal recommendations to a specific person, rather than to address information to the public in general, may amount to investment advice.

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(15) Generic advice about a type of financial instrument is not considered investment advice for the purposes of Directive 2014/65/EU. However, if an investment firm provides generic advice to a client about a type of financial instrument which it presents as suitable for, or based on a consideration of the circumstances of, that client, and that advice is not in fact suitable for the client, or is not based on a consideration of his circumstances, the firm is likely to be acting in contravention of Article 24(1) or (3) of Directive 2014/65/EU In particular, a firm which gives a client such advice would be likely to contravene the requirement of Article 24(1) to act honestly, fairly and professionally in accordance with the best interests of its clients. Similarly or alternatively, such advice would be likely to contravene the requirement of Article 24(3) that information addressed by a firm to a client should be fair, clear and not misleading.

(16) Acts carried out by an investment firm that are preparatory to the provision of an investment service or carrying out an investment activity should be considered as an integral part of that service or activity. This would include, for example, the provision of generic advice by an investment firm to clients or potential clients prior to or in the course of the provision of investment advice or any other investment service or activity.

(17) The provision of a general recommendation about a transaction in a financial instrument or a type of financial instrument constitutes the provision of an ancillary service within Section B(5) of Annex I to Directive 2014/65/EU, and consequently Directive 2014/65/EU and its protections apply to the provision of that recommendation.

(18) In order to ensure the objective and effective application of the definition of systematic internalisers in the Union in accordance with Article 4(1)(20) of Directive 2014/65/EU, further specifications should be provided on the applicable pre-set limits for the purposes of what constitutes frequent systematic and substantial over the counter (OTC) trading. Pre-set limits should be set at an appropriate level to ensure that OTC trading of such a size that it had a material effect on price formation is within scope while at the same time excluding OTC trading of such a small size that it would be disproportionate to require the obligation to comply with the requirements applicable to systematic internalisers.

(19) Pursuant to Directive 2014/65/EU, a systematic internaliser should not be allowed to bring together third party buying and selling interests in functionally the same way as a trading venue. A systematic internaliser should not consist of an internal matching system which executes client orders on a multilateral basis, an activity which requires authorisation as a multilateral trading facility (MTF). An internal matching system in this context is a system for matching client orders which results in the investment firm undertaking matched principal transactions on a regular and not occasional basis.

(20) For reasons of clarity and legal certainty and to ensure a uniform application, it is appropriate to provide supplementary provisions in relation to the definitions in relation to algorithmic trading, high frequency algorithmic trading techniques and direct electronic access. In automated trading, various technical arrangements are deployed. It is essential to clarify how those arrangements are to be categorised in relation to the definitions of algorithmic trading and direct electronic access. The trading processes based on direct electronic access are not mutually exclusive to those involving

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algorithmic trading or its sub-segment high frequency algorithmic trading technique. The trading of a person having direct electronic access may therefore also fall under the algorithmic trading including the high frequency algorithmic trading technique definition.

(21) Algorithmic trading in accordance with Article 4(1)(39) of Directive 2014/65/EU should include arrangements where the system makes decisions, other than only determining the trading venue or venues on which the order should be submitted, at any stage of the trading processes including at the stage of initiating, generating, routing or executing orders. Therefore, it should be clarified that algorithmic trading, which encompasses trading with no or limited human intervention, should refer not only to the automatic generation of orders but also to the optimisation of order-execution processes by automated means.

(22) Algorithmic trading should encompass smart order routers (SORs) where such devices use algorithms for optimisation of order execution processes that determine parameters of the order other than the venue or venues where the order should be submitted. Algorithmic trading should not encompass automated order routers (AOR) where, although using algorithms, such devices only determine the trading venue or venues where the order should be submitted without changing any other parameter of the order.

(23) High frequency algorithmic trading technique in accordance with Article 4(1)(40) of Directive 2014/65/EU, which is a subset of algorithmic trading, should be further specified through the establishment of criteria to define high message intraday rates which constitutes orders quotes or modifications or cancellations thereof. Using absolute quantitative thresholds on the basis of messaging rates provides legal certainty by allowing firms and competent authorities to assess the individual trading activity of firms. The level and scope of these thresholds should be sufficiently broad to cover trading which constitute high frequency trading technique, including those in relation to single instruments and multiple instruments.

(24) Since the use of high frequency algorithmic trading technique is predominantly common in liquid instruments, only instruments for which there is a liquid market should be included in the calculation of high intraday message rate. Also, given that high frequency algorithmic trading technique is a subset of algorithmic trading, messages introduced for the purpose of trading that fulfil the criteria in Article 17(4) of Directive 2014/65/EU should be included in the calculation of intraday message rates. In order not to capture trading activity other than high frequency algorithmic trading techniques, having regard to the characteristics of such trading as set out in recital 61 of Directive 2014/65/EU, in particular that such trading is typically done by traders using their own capital to implement more traditional trading strategies such as market making or arbitrage through the use of sophisticated technology, only messages introduced for the purposes of dealing on own account, and not those introduced for the purposes of receiving and transmitting orders or executing orders of behalf of clients, should be included in the calculation of high intraday message rates. However, messages introduced through other techniques than those relying on trading on own account should be included in the calculation of high intraday message rate where, viewed as