

***Do Trades  
Registered under  
EEX Trade  
Registration Rules  
Qualify as OTC-  
Derivatives under  
EMIR?***

A Legal Assessment for  
European Energy  
Exchange AG, Leipzig

15 May 2014

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# *Executive Summary*

## *The Task*

With confirming the engagement letter, dated 4 April 2014, you have asked us to assess the following question:

Do trades qualify as OTC derivative contracts according to Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation - “EMIR”) upon their registration in accordance with the EEX Trade Registration Rules and, as such, have to be taken into account when calculating the position to be held against the clearing threshold according to Article 10(1) EMIR or can such trades be neglected for this purpose?

## *The Summary*

The trade registration facility provided by EEX according to the Trade Registration Rules qualifies as “regulated market” according to the definition of Article 4(14) MiFID.

With registration of trades in accordance with the Trade Registration Rules of EEX, these trades are executed on a “regulated market” within the meaning of MiFID which excludes them from the definition of “OTC derivative” according to Article 2(7) EMIR.

Trades registered in accordance with the Trade Registration Rules of EEX do not qualify as OTC derivatives and do not need to be considered by so-called non-financial counterparties for calculation of the position to be held against the clearing threshold.

Trades which qualify as “derivative” according to MiFID and were entered into OTC prior to their registration remain OTC derivatives until they are replaced by the new trades executed according to the Trade Registration Rules. After registration the new trade is not qualified as an OTC derivative in the sense of EMIR.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

# Table of contents

1. The Assignment	4
2. OTC Derivative	5
2.1. Derivative Contracts	5
2.2. Execution on a Regulated Market	6
2.2.1 Qualification of Deal Registration as Execution	6
2.2.2 Qualification of EEX as Regulated Market	8
(1.) Multilateral System	9
(a.) Bringing Together Multiple Trading Interests	9
(b.) In the System's Non-Discretionary Rules	10
(c.) Resulting in a Contract over Financial Instruments	11
(d.) Conclusion	11
(2.) Authorization in accordance with Title III	12
(3.) Market Operator	13
(4.) Conclusion on Regulated Market	13
2.3. Conclusion on OTC Derivative	13
3. Conclusion	15
3.1. Consideration of Registered Trades for Clearing Threshold	15
3.2. Consideration of Pre-Existing Trades for Clearing Threshold	15
3.3. Excursus: ESMA's View on Trade Registration Functionalities	15

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

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# 1. *The Assignment*

With confirming the engagement letter, dated 4 April 2014, you have asked us to assess the following question:

Do trades qualify as OTC derivative contracts according to Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (European Market Infrastructure Regulation – “EMIR”) upon their registration in accordance with the EEX Trade Registration Rules<sup>1</sup> and, as such, have to be taken into account by so-called non-financial counterparties when calculating the position to be held against the clearing threshold according to Article 10(1) EMIR or can such trades be neglected for this purpose?

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<sup>1</sup> Release 007a, as published by EEX on 10 April 2014; in the following referred to as “TRR”.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

## 2. OTC Derivative

According to the definition provided for by EMIR in Article 2(7), “*OTC derivative*’ or ‘*OTC derivative contract*’ means a derivative contract the execution of which does not take place on a regulated market as within the meaning of Article 4(1)(14) of Directive 2004/39/EC”.

For the purpose of this assignment the following needs to be assessed

- whether the trades registered in accordance with the TRR qualify as derivative contracts (2.1) and
- whether they are executed on a regulated market within the meaning of the above definition (2.2).

### 2.1. Derivative Contracts

According to Article 2(5) EMIR, “*derivative*’ or ‘*derivative contract*’ means a financial instrument as set out in points (4) to (10) of Section C of Annex 1 to Directive 2004/39/EC as implemented by Article 38 and 39 of Regulation (EC) 1287/2006”.

The definition of financial instrument as set out in points (4) to (10) of Section C of Annex 1 to Directive 2004/39/EC on markets in financial instruments (such Directive in the following referred to as “MiFID”) encompasses “*options, futures, swaps, forward rate and other derivative contracts relating to commodities*”, such as e.g. power, gas and oil, that “*must be settled in cash*”<sup>2</sup> or, provided they are traded on an MTF or regulated market, “*can be physically settled*”<sup>3</sup>. Excluded from the definition of financial instruments are spot contracts, i.e. contracts for the sale of a commodity under the terms of which delivery is scheduled to be made within two days or the period generally accepted in the market for that commodity as the standard delivery period.<sup>4</sup>

The trade registration functionality as defined by the TRR<sup>5</sup> is offered for all “EEX Spot and Derivative Markets” products as determined by the Exchange Council and published by the Management Board of the EEX<sup>6</sup>. These products, in the following also referred to as “Exchange Traded Products” or “ETP”, are specified in the Contract Specification as published by EEX from time to time.<sup>7</sup> Trade Registration Functionality is also offered

<sup>2</sup> See point (5) of Section C of Annex 1 to MiFID.

<sup>3</sup> See point (6) of Section C of Annex 1 to MiFID.

<sup>4</sup> See Article 38(2) Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive, in the following referred to as “Regulation (EC) 1287/2006”, in the following referred to as Regulation (EC) No 1287/2006.

<sup>5</sup> In the following also referred to as “Trade Registration Functionality”.

<sup>6</sup> See §1(4) TRR in conjunction with §4 TRR

<sup>7</sup> Release 0038a, published 3 April 2014, in the following referred to as “ContrSpec”.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

for certain products which cannot be traded on the Spot and Derivative Markets of EEX and which are specified in the “Contract Specifications for Trade Registration”<sup>8</sup> as published by EEX from time to time.<sup>9</sup>

As can be taken from the different product specifications all of the products financially settled according to the TRSpec or ContrSpec are futures, options or swaps relating to commodities such as gas, power, emission rights or coal. These financially settled product are derivatives within the meaning of Section C of Annex 1 to MiFID and thus within the meaning of EMIR.

All contracts specified for the EEX Spot Markets as well as those titled as “physical futures” are to be fulfilled by delivery of the commodity sold or purchased according to such specifications. Thus, they can be physically settled and do qualify in this respect as derivatives according to point (6) of Section C of Annex 1 to MiFID, only if they are traded on a regulated market or MTF.

If, however, trading these physical products by way of registration according to TRR qualified these physically settled products as “traded on a regulated market”, they would automatically be disqualified as OTC derivatives according to EMIR. As elaborated above, the definition of OTC derivatives applies only to derivatives “the execution of which does not take place on a regulated market”.

For the purpose of this assignment, however, it does not need to be further assessed whether and to what extent the physical products registered according to TRR qualify as derivatives. If the registration qualified as execution of trades at a regulated market, neither the physically settled nor the financial contracts would qualify as OTC derivatives.

## ***2.2. Execution on a Regulated Market***

In the following it needs to be assessed if the registration of trades under the TRR qualifies as execution of trades on a regulated market.

### ***2.2.1 Qualification of Deal Registration as Execution***

Execution within the meaning of Article 2(7) EMIR is not further defined in EMIR. However, the mere meaning of the word “execution” in connection with (derivative) “contracts” implies that it means, if not the conclusion of a contract itself, at least the initiation of the conclusion of a contract.

The reason for not using the word “conclusion” but the term “execution” in Article 2(7) EMIR may simply allude the fact that on a regulated market the matching of a buy and sell interest regularly leads not to one contract between the buyer and the seller. Instead, matching bid and offers – depending on the contractual set-up and the parties involved in a given case – regularly leads to a chain of multiple contracts between multiple

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<sup>8</sup> Specifications for Trade Registration, Release 005b, published 10 April 2014; such Release in the following referred to as “TRSpec”

<sup>9</sup> See §4 TRR.

parties. This chain may include - besides the parties with the original buy and sell interest - also brokers, clearing members and clearing houses.

Whether “execution”, with respect of its legal consequences, is less than or takes place prior to “conclusion”, i.e. the entering into a legally binding agreement, however, is irrelevant for the purpose of this assessment. If execution is less than conclusion of a contract any conclusion of a contract or, as the case may be, the chain of contracts between the parties involved, by way of registration will also qualify as execution in the meaning of Article 2(7) EMIR.

The TRR differentiates two scenarios with respect to deal registration:

1. The conclusion of new trades by means of the registration according to §1(2) in connection with §§5 to 10 TRR.
2. The registration of already existing trades according to §1(3) TRR and, as the case may be, so called “legacy trades” in connection with §11(3) TRR.

In any case of registration according to either of the two scenarios, a new trade is concluded upon one party’s confirmation of the trade details previously entered into the respective trading system of EEX by the other party. In case of scenario 2 above, such entry into the trading system encompasses twofold offers: one is an offer for cancellation of the pre-existing trade, i.e. the trade that was entered into by the parties outside of the EEX system, i.e. “over the counter”, and prior to the entering of the offer into the EEX system. The second offer is a simultaneous offer to conclude a new trade in accordance with the rules and regulations of EEX with the commercial terms as entered into the system. The confirmation by the other party constitutes the acceptance of both offers.<sup>10</sup> As a result, the new trade concluded in the EEX system replaces the previously existing OTC trade which ceases to exist.

According to §14 TRR, *“upon the legally binding registration of the trades, the regulations regarding the conclusion of trades and regarding the contractual obligations of the clearing conditions of the ECC (...) shall apply accordingly with regards to the contractual relationships between ECC AG (...) and the trading participants involved in the registered trade and/or their clearing members”*.

Section 3.4.1. (1)(b) of the clearing conditions of the ECC<sup>11</sup> stipulates that upon entering a trade for registration into the system, a transaction is concluded between this non-clearing member and its clearing member and, at the same time, a corresponding transaction is concluded between this clearing member and ECC.

Thus, regardless of the scenarios described above, with registration of the trade in accordance with the TRR, not one contract but a chain of contracts between the buyer, its clearing member at ECC AG as seller to the buyer

<sup>10</sup> See §1(3) TRR.

<sup>11</sup> Clearing Conditions of the European Commodity Clearing AG, Release 0021b as published on 15 January 2014, in the following referred to as “Clearing Conditions”.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig



and as buyer from ECC AG is entered into as well as a corresponding chain between the seller, the seller's clearing member as buyer from the seller and as seller to ECC AG. The registration, therefore, leads to a chain of four contracts with up to five different counterparts. In case of a registration under scenario 2 as described above, the original trade would be replaced not by one but by a total of four trades.

In either scenario, with the conclusion of these trades, at the latest, such trades are being "executed" within the meaning of Article 2(7) EMIR.

## ***2.2.2 Qualification of EEX as Regulated Market***

In the following, it will be further assessed whether the execution by way of trade registration according to the TRR takes place on a "regulated market" within the meaning of MiFID.

According to Article 4(1)(14) MiFID "[r]egulated market means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorized and functions regularly and in accordance with the provisions of Title III".

According to this definition, a "regulated market" has to fulfil the following requirements:

1. It is a multilateral system which
  - a. brings together multiple third-party buying and selling interests in the system
  - b. in accordance with non-discretionary rules and
  - c. in a way that result in a contract in respect of the financial instruments admitted to trading under its rules
2. which is authorized and functions regularly and in accordance with the provisions of Title III and
3. is operated and/or managed by market operator.

While the requirements described under 1 relate to more material prerequisites a "multilateral system" needs to comply with in order to form a "regulated market", the requirements under 2 relate more to formal aspects such as the authorization of the operator and the regulatory environment the system needs to comply with.

In the following it has to be assessed whether these requirements of a regulated market according to Article 4(14) MiFID are met by the Trade Registration Functionality operated by EEX AG.

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## **(1.) Multilateral System**

The Trade Registration Functionality must be a “multilateral system” as required by MiFID.

There is no separate definition in MiFID for the term ‘multilateral system’. However, according to the definition of regulated market in Article 4(14) MiFID, the formal authorization and regular functioning in accordance with the provisions of Title III MiFID is required for a multilateral system which (a.) brings together or facilitates the bringing together of multiple third party buying and selling interests in the system, (b.) in accordance with its non-discretionary rules and (c.) in a way that result in a contract in respect of the financial instruments admitted to trading.

If these requirements are met, the Trade Registration Functionality fulfills the material prerequisites of a multilateral system according to MiFID.

### **(a.) Bringing Together Multiple Trading Interests**

Other than order book trading on the exchange as operated by EEX, where multiple buy and sell orders of trading participants are matched with each other during the execution process on the mere basis of price and volume and regardless of the identity of any of the trading participant<sup>12</sup>, registered trades are executed “by mutual consent” of only two registration participants<sup>13</sup> the identity of which is mutually known to each other prior to the execution and which during the registration process bilaterally agree on volume and price<sup>14</sup>.

It is therefore questionable that trade registration according to the TRR actually brings together “multiple third party buying and selling interests in the system” as required according to the description of “multilateral system” within the definition of regulated market.

According to the rationale of this definition as expressed in Recital 6 of MiFID, however, the definition was meant to “*exclude bilateral systems where an investment firm enters into every trade on own account and not as a riskless counterparty interposed between buyer and seller*”<sup>15</sup>. This clarification is twofold:

One, it clarifies that the system must bring together the trading interests of multiple market participants to trade amongst each other as opposed to all of these participants bringing their trading interests together with the corresponding but own interest of just one other counterparty.

The second dimension of this clarification is that the system still qualifies as “multilateral” even if the multiple interests are brought together only indirectly, through one and the same counterparty which does not have any original trading interest but acts as counterpart for both, the selling and buying participant with, in each case,

<sup>12</sup> See Sections 3 and 4 of the Trading Conditions, Release 0036a as published by EEX AG on 10 April 2014; in the following also referred to as “Trading Conditions”.

<sup>13</sup> See §1(2) TRR.

<sup>14</sup> See §§1(2), 5 to 10 TRR and §§1(3), 11(3) TRR for pre-existing/legacy trades.

<sup>15</sup> See Recital 6, second sentence.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

corresponding interest but without taking any (market) risk. Typically clearing houses and CCP regulated under EMIR act as such riskless counterparts interposed between buyer and seller. Thus, Recital 6 clarifies that systems according to which trades executed by the participants are eventually cleared through a central counterparty can still qualify as “multilateral” within the meaning of Article 4(14) MiFID.

According to this understanding it is sufficient for a system to qualify as a “multilateral system” that multiple participants can bring their buying and selling interests to the system provided by the market operator and find access to multiple corresponding buying and selling interests. This is regardless of the fact that a system requires that the contracts conclude are eventually concluded with a central counterparty which acts as the counterpart with corresponding interest for each of the parties.

Though trades are executed bilaterally by two participants during the trade registration process according to the TRR, all trade registration participants can choose from all exchange as well as registration participants admitted as such by EEX.<sup>16</sup> Thus, they have access to multiple potential counterparts and their buying and selling interests provided to them by the registration system operated by EEX. Thus, the system is “multilateral” in this respect.

The fact that upon execution of each such trade these trades are being concluded in the chain of clearing participants with ECC AG acting as the central counterparty for all participants does not conflict the concept of multilateral system as required by Article 4(14) MiFID as neither ECC AG nor any of the clearing members involved in the contract chain take risk in the contracts concluded by trade registration.

The fact that registration participants know the identity of and choose their counterpart, i.e. the holder of the corresponding trading interest, prior to the execution of the intended trade does also not conflict with the requirements for multilateral system. Multilateral to this extent does not require that the corresponding buying and selling interests need to be anonymously matched with each other. That is why “technical” systems for matching orders, i.e. trading platforms are not required for a system to qualify as regulated market.<sup>17</sup> Fully sufficient in this respect is that the interests are brought together under the system’s non-discretionary rules.

### ***(b.) In the System’s Non-Discretionary Rules***

The requirement that the interests be brought together in the system by means of “non-discretionary rules” means that they are brought together merely by the system’s rules, leaving the operator of the system with no discretion as to how interests of the participants, i.e. the users of the system, may interact<sup>18</sup>.

As already described, how trades are being registered for execution, for what products and who is admitted to the trade registration is stipulated in the Exchange Rules, the TRR, the ContrSpec as well as the TRSpec. These rules have to comply with the German Exchange Act which requires non-discriminatory access and non-

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<sup>16</sup> See §2(1) TRR.

<sup>17</sup> See Recital 6, fourth sentence.

<sup>18</sup> See Recital 6, seventh sentence.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

discretionary execution of trades<sup>19</sup>. The compliance with such rules is being supervised by the same bodies and institutions responsible for the supervision of the exchange, including the Exchange Supervisory Authority, the Saxon State Ministry of Economic Affairs, Labor and Transport<sup>20</sup>. Within this framework of admission, rules and supervision only, participants are free to trade with each other without any discretion of EEX to only bring the interests of certain participants together or stop them from trading with each other on the TRR.

Thus, trades registered according to the set of rules are entered into on the basis of non-discretionary rules and, thus, the trading interests of registration participants are brought together according to non-discretionary as the rules of the system.

### ***(c.) Resulting in a Contract over Financial Instruments***

The bringing together of corresponding buying and selling interests must further result in contracts over financial instruments admitted to trading under the system's rules, i.e. the Trading Registration Rules.

As elaborated above, trade registration according to the TRR leads to the conclusion of contracts.<sup>21</sup> Such contracts – at least with respect to the financially settled products and physically settled futures - do qualify as “derivatives” within the meaning of MiFID and EMIR.<sup>22</sup> According to Section C of Annex 1 to MiFID, derivatives are a sub-group of what MiFID defines as financial instruments.

These financial instruments must have been admitted to trading in accordance with the system's rules prior to their conclusion. Such prior admission of products for trading as part of the multilateral system's requirements separates “regulated markets” within the meaning of Article 4(14) MiFID from “Multilateral Trading Facilities” or “MTF” as defined in Article 4(15) MiFID the regulatory framework for which is further stipulated in Title II of MiFID.

As elaborated above, not only how trades are being executed and by whom is stipulated in the TRR, but also what products are admitted to registration. Only products specified in the ContrSpec or TRSpec are admitted according to §1(4) TRR in conjunction with §4 TRR.

Thus, TRR registration leads to contracts over financial instruments admitted to trading in accordance with its rules and also meets this prerequisite of the definition of “multilateral system”.

### ***(d.) Conclusion***

The Trade Registration Functionality operated by EEX AG fulfil the material requirements of a “multilateral system” as stipulated for such system in the definition of “regulated market” in Article 4(14) MiFID.

<sup>19</sup> See Sections 19 (2) to (5), 32 (3), 33 German Exchange Act

<sup>20</sup> Sächsisches Staatsministerium für Wirtschaft, Arbeit und Verkehr (in the following referred to as “SMWA”).

<sup>21</sup> See above at Section 2.2.1.

<sup>22</sup> See above at Section 2.1.

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In the following it will be further assessed if the multilateral system also meets the formal requirements with respect to its authorization and its qualification as an operator.

## ***(2.) Authorization in accordance with Title III***

The definition of “regulated market” according to Article 4(14) MiFID further requires that the multilateral system “*is authorized and functions regularly and in accordance with the provisions of Title III [of MiFID]*”.

EEX holds a license granted by the SMWA to operate an energy exchange. For the purpose of this assigned assessment and without having further investigated, it is assumed that the SMWA is the competent authority according to the German Exchange Act<sup>23</sup> and the relevant State Law of the State of Saxony to grant such license.

Among other pieces of legislation, the German Exchange Act is the German legislation implementing MiFID<sup>24</sup>, in particular Title III of MiFID<sup>25</sup> which defines the frame for the regulatory requirements for regulated markets organized and operated within the Member States. Licenses granted under the German Exchange Act are authorization by the competent authorities to operate a regulated market as required by Title III of MiFID. Holding such license, EEX AG does operate a regulated market in accordance with such MiFID requirement. Accordingly, it is listed in the register of regulated markets published on the ESMA website<sup>26</sup>.

The execution of trades according to the TRR, however, is not participation in order book trading on the exchange. Though TRR require the users of the Trade Registration Functionality to be admitted as either trading participant of the exchange or so called “Trade Registration participant”<sup>27</sup>, the mere admission as the latter is limited to the registration of trades, only. It does not permit participation in order book, i.e. auctions or continuous trading on the exchange organized by EEX<sup>28</sup>.

If, however, access to the exchange requires other prerequisites to be met than the access to the Trade Registration Functionality, one could argue that operating the Trade Registration Functionality as such does also not fall within the scope of the exchange, i.e. that part of the regulated market that is authorized through the license of the SMWA.

<sup>23</sup> Börsengesetz (BörsenG) as published on 16 July 2007 (BGBl. I S. 1330) and amended last by Article 10 AIFM-Umsetzungsgesetz of 4 July 2013 (BGBl. I S. 1981).

<sup>24</sup> MiFID was implemented through the “Gesetz zur Umsetzung der Richtlinie über Märkte für Finanzinstrumente und der Durchführungsrichtlinie der Kommission (Finanzmarkttrichtlinie-Umsetzungsgesetz)” as of 16 July 2007, BGBl. I pp. 1330 et seq. (in the following referred to as the “Financial Market Directive Implementation Act” or “FMDIA”) which amended multiple pieces of German legislation applicable to the financial industry.

<sup>25</sup> See p. 81 of the explanatory memorandum to draft FMDIA on Section 4 German Exchange Act, the license requirement for “exchanges”, published in BT-Drucks. 16/4028.

<sup>26</sup> See at: [http://mifidatabase.esma.europa.eu/Index.aspx?sectionlinks\\_id=23&language=o&pageName=REGULATED\\_MARKETS\\_Display&subsection\\_id=0](http://mifidatabase.esma.europa.eu/Index.aspx?sectionlinks_id=23&language=o&pageName=REGULATED_MARKETS_Display&subsection_id=0) (accessed on 14 May 2014).

<sup>27</sup> See §2(1) TRR.

<sup>28</sup> See §2(2) TRR.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig



MiFID does not use the term “exchange” which is used only in the German legislation implementing MiFID. As can be taken from the explanatory memorandum for the German MiFID Implementation Act, the term “exchange” as defined in the German Exchange Act goes beyond the scope of the definition of “regulated markets” of MiFID<sup>29</sup>. This is why not each and every of the functionalities under which trades can be executed on an “exchange” according to the German Exchange Act may qualify as an execution on a “regulated market” according to MiFID.

However, as elaborated above, the Trade Registration Functionality fulfills all of the material prerequisites of a “regulated market” according to MiFID. This is why its operation falls under the requirement as stipulated in Title III of MiFID. Thus, it is only reasonable to assume that with implementing a license requirement for operating an “exchange” through the German Exchange Act, the German legislator wanted to capture all activities which materially fulfill the operation or management of a regulated market under the license requirements stipulated in the German Exchange Act. Accordingly, the license granted by the SMWA also captures the operation of the Trade Registration Functionality by EEX AG.

### ***(3.) Market Operator***

Market operator means a person who manages and/or operates the business of a regulated market.<sup>30</sup>

EEX, a legal person, manages and operates the trade registration according to its rules. It is “market operator” within the meaning of Article 4(14) MiFID.

### ***(4.) Conclusion on Regulated Market***

The operation of the Trade Registration Functionality by EEX fulfills all material and formal requirements of a “regulated market” within the meaning of the definition of Article 4(14) MiFID.

#### ***2.2.3 Conclusion on Execution of Regulated Market***

As the registration of trades in accordance with the TRR leads to a conclusion of a chain of corresponding trades as elaborated above, the registration is an “execution of trades on a regulated market” within the meaning of Article 2(7) EMIR.

### ***2.3. Conclusion on OTC Derivative***

None of the products executed in accordance with the TRR qualify as “OTC derivative” within the meaning of Article 2(7) EMIR due to the fact that they either do not qualify as “derivatives” or are “derivatives the execution of which takes place on a regulated market”.

<sup>29</sup> See explanatory memorandum to draft FMDIA, published in BT-Drucks. 16/4028, p. 79.

<sup>30</sup> See Article 4(13) MiFID.

As elaborated above, the financially settled products executed at EEX in accordance with the TRR qualify as derivatives in the meaning of MiFID and accordingly EMIR. They do not qualify as OTC derivative contracts within the meaning of Article 2(7) EMIR as they are executed on a regulated market.

The same applies to those physically settled products which qualify as derivatives because they are executed on a regulated market according to Point 6 of Section C of Annex 1 to MiFID.

Finally, physically settled products which are executed in accordance with the TRR and which are spot transactions according to Article 38 Regulation (EC) No 1287/2006 do not qualify as derivatives and consequently do also not qualify as OTC derivatives within the meaning of Article 2(7) EMIR.

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## 3. Conclusion

### 3.1. Consideration of Registered Trades for Clearing Threshold

According to our assessment none of the trades registered in accordance with the TRR qualify as OTC derivative contracts according to EMIR.

According to Article 10(1) EMIR certain obligations as specified further in EMIR, in particular clearing and certain risk mitigation obligations, apply to so called non-financial counterparties where (such counterparty) takes position in OTC derivative contracts and those positions exceed the clearing threshold as specified in Article 10(3) EMIR and Chapter VII of Delegated Regulation (EU) No 149/2013<sup>31</sup>.

Since trades registered in the trade registration facility organized by EEX do not qualify as OTC derivative, they do not need to be considered in calculating the position for comparing it with the applicable clearing threshold.

### 3.2. Consideration of Pre-Existing Trades for Clearing Threshold

As elaborated under 2.2.1 above, the TRR also allow for the registration of “legacy” and other trades concluded between two trading parties prior to their registration.

For the purpose of clarification, it needs to be said that as long as the pre-existing trades are not replaced in the registration process, they remain existing as OTC transactions.

Provided such a pre-existing OTC transaction qualifies as “derivative” as specified by MiFID, it will also qualify as “OTC derivative” within the meaning of Article 2(7) EMIR and, consequently, will need to be considered for calculating the position relevant for the clearing threshold.

### 3.3. Excursus: ESMA’s View on Trade Registration Functionalities

The conclusions under 3.1 and 3.2 above are consistent and in line with ESMA’s view expressed in its “OTC Answer 1” under lit. (d) published in its “Questions and Answers on Implementation of the Regulation (EU)

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<sup>31</sup> Delegated Regulation (EU) No 149/2013 of 19 December 2012 supplementing Regulation (EU) No 648/2012 of the European Parliament and the Council with regards to regulatory technical standards on indirect clearing arrangements, the clearing obligation, the public register, access to the trading venue, non-financial counterparties, and risk mitigation techniques for OTC derivatives contracts cleared by a CCP.



No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR)” as amended and edited from time to time and accessible on the ESMA website<sup>32</sup>.

In answering OTC Question 1 lit. (d) on whether derivative contracts executed outside a regulated market, but processed by an exchange and cleared by a CCP should be considered OTC derivatives for the purpose of determining whether a non-financial counterparty has reached the clearing threshold according to Article 10 EMIR, ESMA elaborates as follows:

*“Derivatives transactions (...) which are executed outside the trading platform of the regulated market, but are subject to the rules of the regulated market and are executed in compliance with those rules, including the immediate processing by the regulated market after execution and the clearing by a CCP, should not be regarded as OTC derivatives transactions. Therefore, these transactions should not be considered for the purpose of the clearing obligation and the calculation of the clearing threshold by NFC that only relates to OTC derivatives.”*

According to this statement, ESMA even considers derivative transactions not to be OTC derivatives which are executed on trading platforms outside the regulated market as long as they are processed by an exchange and cleared by a CCP. This supports the understanding that the place of execution is irrelevant for the differentiation between OTC and non-OTC as long as upon execution the transaction is processed and cleared like a transaction that was executed on a regulated market.

Following this logic, trades registered according to the TRR would even be considered non-OTC if the execution by registration on the Trade Registration Facility operated by EEX was considered an execution outside of the regulated market of the exchange. As elaborated above, upon their registration, these trades are processed by facilities of the exchange and cleared by ECC as CCP for trades registered under the TRR.<sup>33</sup> According to the logic ESMA applies in its answer, trades registered in accordance with both alternatives stipulated in § 1 para. 2 and 3 of the TRR will be considered non-OTC upon their registration.

Especially, those transactions that upon their registration replace pre-existing or “legacy trades” according to §§1(3), 11(3) TRR, i.e. transactions originally concluded by the parties outside the Trade Registration Facility.<sup>34</sup> As highlighted above, while these pre-existing trades are and remain OTC traded until they are being cancelled and replaced by the trades executed in the registration process, the trades replacing these pre-existing trades are non-OTC, i.e. executed on a regulated market.

This understanding is also supported by ESMA’s expressed view in its elaborations on the second paragraph of OTC Answer 1 lit. (d):

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<sup>32</sup> See at: [http://www.esma.europa.eu/system/files/2014-297\\_qa\\_vii\\_on\\_emir\\_implementation\\_20\\_march\\_14\\_0.pdf](http://www.esma.europa.eu/system/files/2014-297_qa_vii_on_emir_implementation_20_march_14_0.pdf) (accessed on 14 May 2014).

<sup>33</sup> See above at 2.2.1 and 2.2.2 (a).

<sup>34</sup> See above at 2.2.1.

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Do Trades Registered under EEX Trade Registration Rules Qualify as OTC-Derivatives under EMIR? - A Legal Assessment for European Energy Exchange AG, Leipzig

*“Derivatives transactions that do not meet the conditions listed in the first paragraph of this subanswer (d) should be considered OTC. For example, derivatives contracts that are not executed on a regulated market and are not governed by the rules of an exchange at the point of execution should be considered OTC even if after execution they are exchanged for contracts traded in a regulated market. However, the replacement contract itself may be considered exchange traded if it meets the relevant conditions.”*

While the second part of the second sentence starting with “even if” may be a little misleading as it may be understood as if the trades replacing the transactions entered outside of a regulated market need to be considered OTC, the last sentence of the paragraph clarifies that these replacement trades may be considered “exchange traded”, i.e. traded at a regulated market, as long as they are processed and cleared accordingly.

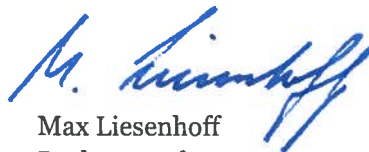
Applying ESMA’s understanding of the registration of legacy trades according to the TRR, it confirms the conclusion stipulated above that until their registration legacy trades will be considered OTC trades while the replacement trades will not.

Düsseldorf, 15 May 2014

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