



June 22<sup>th</sup>, 2015

**To Lord Jonathan HILL, EU Commissioner for Financial Stability, Financial Services and Capital Markets Union**

**Subject: MiFID II Commodities – ESMA draft Technical standards (RTS) on position limits, position reporting and ancillary activities**

**Dear Mr Commissioner,**

We are writing to you in the context of ESMA finalising the implementing rules of MiFID II which affect commodities, notably;

- setting of mandatory position limits;
- establishment of a position reporting regime; and
- revision of the MiFID boundary, including changes to the ancillary activities for the purpose of the general exemption rule.

We acknowledge and appreciate the efforts of the European Commission to co-operate with other regulatory authorities and the industry in delivering an appropriate regime for commodity derivatives markets.

However, the undersigned Associations which represent commodity producers and suppliers as well as commodity end-users, buy-side firms and financial participants remain seriously concerned about the design and calibration of the implementing rules currently under consideration. Specifically, we are concerned that the proposals outlined above may severely affect commodity markets, commodity consumers and the real economy. This may in turn undermine the European Commission's EUR 315 billion

investment plan published on 26 November 2014 to create growth and jobs within the EU market, to make Europe more attractive to investment and to remove regulatory bottlenecks.

As regards **position limits**, the proposed methodology and in particular the combination of several factors<sup>1</sup> is likely to lead to a major contraction of the provision of hedging services to EU organisations which will affect the efficiency of hedging programmes and result in increased costs to consumers.

It is critical that the implementing rules are appropriately calibrated and reflect market dynamics to minimise unintended costs to these hedging organisations, including commodity end-users and producers, and consequently prices paid by ultimate end-retail customers.

Liquid commodities markets require a variety of participants: buyers, sellers and market makers. To hedge the risks inherent in their commercial activities, corporates depend on the willingness of market makers to assume appropriate market and credit risk as intermediaries. The current rules require financial intermediaries to ensure that their exposure in MiFID instruments complies with the proposed limits; consequently the ability to net risk is crucial for these entities.

ESMA's proposed limitation of netting to MiFID instruments is one aspect of the rules which will adversely affect markets on which end users rely. Without the ability to manage risk in physical and non MiFID instruments intermediaries would be restricted in their ability to offer hedging services to corporates. Moreover, in the event that options for hedging diminish, corporates may come under pressure to tie-up their own capital in holding physical inventories (and in establishing the related infrastructure to manage those inventories) to manage their risk and/or face much more expensive hedging costs as a consequence. Concerns around market integrity and operation of netting rules will be addressed by intermediary position reporting to NCAs. As such, we suggest NCAs propose netting rules which reflect market dynamics as they will be in a position to ensure that financial intermediaries are conducting netting in an appropriate manner and can correct or provide further guidance in relation to any improper netting practices.

Although the position limit regime exempts risk reducing positions of corporates, the application process for benefiting from this exemption makes it unworkable by establishing a pre-approval system. End-users need to hedge immediately. If they have to get their hedges pre-approved (and possibly to wait for up to 30 calendar days), they will lose the ability to hedge on a timely basis and have to carry price risk for a pre-approval period.

We also note that in theory NCAs should apply position limits to transferable securities which are caught by the definition of commodity derivatives in MiFID II (under annex 1 section C.10) although many of these products are not commodity contracts (e.g. inflation swaps) or it would be impractical for NCAs to apply position limits (e.g. Luxembourg CSSF and commodity linked securities). There is no deliverable supply or open interest in these contracts and/or securitised products and the application of position limits does not make sense.

Regarding the **position reporting** rules, the reporting of end-clients details through a chain of intermediaries conflicts with a number of national criminal laws on data protection and blocking status (i.e. prohibition of transfer of personal data to foreign authorities), as well as confidentiality and access issues faced by investment firms. In our view, a legal and practical solution that enables market competent

---

<sup>1</sup> These factors include restrictive netting, aggregation rule without exception, use of deliverable supply as a metric for non-spot month contracts, hedging exemption application process based on pre-approval.

authorities to access data without conflicting with these rules is optimal. Given the legal and regulatory constraints, as well as the coordination needed among the various market participants, we encourage ESMA and the Commission formally propose an IT solution that would allow the encryption of data and details.

As a practical matter, these issues are compounded by the uncertainty concerning the external elements of the **ancillary activity test** (e.g. market size in individual asset classes) due to a lack of reliable data, as well as timing issues faced by firms being required to comply with MiFID II licensing requirements from January 2017 and related regulations (e.g. CRD IV, MAR). Specifically, as MiFID II fully applies from the 3<sup>rd</sup> of January 2017, ancillary activity tests will need to be performed based on average data for 2016 (which will unlikely be available in such a short timeframe) and, in the case of failing the ancillary activity test, firms will need to apply for and get a license allowing to perform financial services by 3<sup>rd</sup> January 2017 (although the process takes more than one year on average).

Furthermore, there is an additional risk for the European Union (EU) that liquidity of commodity derivatives markets will move away as banks as well as commodity trading firms will be forced to downsize or stop their trading activities which consequently will adversely affect growth and jobs. For these reasons the European Federation of Energy Traders (EFET), FIA Europe, the GFMA Commodities Working Group, the International Emissions Trading Association (IETA) and the International Swaps and Derivatives Association (ISDA) urge the European Commission to consider, where necessary, changes in the draft RTS to make the position limits and position reporting regimes and the ancillary activities definition more workable and more supportive of the benefits that a liquid commodity market brings to Europe.

In summary therefore, we recommend the following adjustments:

1. Publication of the methodology for calculating deliverable supply for spot months and utilising open interest as a basis for calculating non-spot months limits and the application of the position limit regime to commodity contracts not other asset classes;
2. A definition of economically equivalent OTC derivative contract that allows certain commodity OTC derivatives that are correlated to on-venue contracts to be offset against on-venue contracts (which are significant for end user hedging);
3. Netting rules allowing netting of non-MiFID instruments with MiFID instruments when calculating a net position to reflect that end users rely on MiFID regulated entities for supply of physical commodities and that these MiFID regulated entities enter into on-venue contracts to hedge their risk of these physical positions;
4. A workable data encryption system or other similar mechanism for position reporting implemented by NCAs and ESMA in close coordination with the industry;
5. A revision of the ancillary activity thresholds to take account of the uncertainties around the elements of the ancillary activity test that are caused by the lack of reliable data and of the impracticable timeline regarding the calculation of thresholds and the application procedure to get a MiFID license.

We are keen to continue a constructive dialogue with the European Commission, ESMA and the European Parliament on this subject and stand ready to assist as this work is finalised.

Sincerely yours

Jan Van Aken  
Secretary General  
EFET



Simon Puleston-Jones  
Chief Executive Officer  
FIA Europe



David Strongin  
GFMA



Sarah Deblock  
European Policy Director  
IETA



Scott O'Malia  
Chief Executive officer  
ISDA



To:

Lord Hill, DG FISMA (Financial Stability, Financial Services and Capital Markets Union) Commissioner

Cc:

Jonathan Faull, DG FISMA (Financial Stability, Financial Services and Capital Markets Union) Director General

Roberto Gualtieri, Chairman of the European Parliament Economic and Monetary Affairs committee

Markus Ferber, Member of the European Parliament, MiFID Rapporteur

Steven Maijor, ESMA Chairman

Verena Ross, ESMA Executive Director

**EFET**

The European Federation of Energy Traders (EFET) promotes and facilitates European energy trading in open, transparent, sustainable and liquid wholesale markets, unhindered by national borders or other undue obstacles.

We currently represent more than 100 energy trading companies, active in over 27 European countries. For more information, visit our website at [www.efet.org](http://www.efet.org).

**FIA Europe**

FIA Europe, formerly the Futures and Options Association (FOA), represents some 175 firms involved in the exchange-traded and centrally-cleared derivatives markets – including banks, brokers, commodity firms, exchanges, CCPS, vendors, law firms and consultants. FIA Europe works with its members to maintain constructive dialogue with government and regulatory authorities and deliver high standards of industry practice. In 2013, FIA Europe formed an affiliation with FIA under a new structure – FIA Global. Under this arrangement, FIA, FIA Europe and FIA Asia have strengthened their influence on cross-border issues, substantially increasing the coordination and information flow between regions and providing a powerful global voice to express the views of their members. The organisations preserve their ability to deal with legislative, regulatory and market issues in their respective time-zones and continue to operate with their own leadership and staff, separate boards of directors and distinct memberships.

**GFMA**

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit [www.gfma.org](http://www.gfma.org).

GFMA is registered on the EU Transparency Register, registration number 898223513605-51.

**IETA**

IETA is the voice of business on carbon markets around the world. Established in 1999, IETA's members include global leaders in the oil, electricity, cement, aluminium, chemical, paper, technology, data verification, broking, trading, legal, finance, and consulting industries.

**International Swaps and Derivatives Association**

Since 1985, ISDA has worked to make the global OTC derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 67 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and Commodities firms and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: [www.isda.org](http://www.isda.org).