

Position paper on the European Commission's proposals on MAD and MAR

Date: January 2012

The FOA is the industry association for more than 160 firms and institutions which engage in derivatives business, particularly in relation to exchange-traded transactions, and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector (see Appendix 1).

MAR:

1. Summary

- **Agree that MAR is a “fundamental pillar” for a coherent single financial services market;**
- **Agree that MAR will reduce legal complexities and offer greater certainty;**
- **Support extension to financial instruments traded on MTFs and OTFs as well as regulated markets and financial instruments traded OTC;**
- **Support closer alignment of definitions as they apply to financial and commodity markets, BUT concerned about the broad and uncertain definition of inside information; and**
- **Note that the classification of emission allowances as ‘financial instruments’ under MiFID is not finalised, and hence the inclusion of these allowances in MAR may prove unnecessary.**

2. More clarity needed re “inside information” definition in relation to derivatives on commodities.

The definition of “inside information” in relation to commodities in Article 6 (1) (b) should be made more clear and precise. The use of the word “notably” is not helpful and should be removed.

The inclusion of information on the grounds that it is regarded by a reasonable investor as “relevant” (Article 6 (1) (e)) is far too broad. This could unintentionally cover any form of commercially-sensitive information – see **Annex 1** for illustrative scenarios.

3. If more clarity is not provided, and no defences are available, there will be a “chilling” effect on the real economy, as legitimate commercial activities are hindered.

These legitimate activities include exercising trading discretions, hedging underlying assets, and managing changes in supply and demand, and to meet contractual delivery obligations. The current definition should only apply to events outside of normal operational activities.

4. Some of the provisions in the Regulation on Energy Market Integrity and Transparency (REMIT) may be appropriate to include in MAR.¹

These REMIT provisions preserve the ability of firms to enter into legitimate commercial and risk management trading activities. These activities must involve the use of commercially confidential (to the firm) information.

¹ FOA understands that the technical standards and thresholds supporting REMIT have yet to be drafted

REMIT provides that information on a market participant's own plans and strategies for trading should not be considered as inside information. It also sets out that dealings necessary to cover loss from unplanned outages or act under national emergency rules (e.g. confidential data, such as marginal cost information, on individual power plants, should be exempted insofar as it is information that no market participant could reasonably expect to receive). While this is relevant to producers and operators of storage and transport facilities, it is equally important for other market participants (and the FOA believes that the adoption of a narrower and more appropriate definition of inside information will mean that any exemption of this nature would not be a licence to trade on inside information).

MAD:

1. Summary:

- **Recognise the importance of criminal convictions for market abuse offences;**
- **Support mandated application of criminal offences;**
- **Support the introduction of inciting, aiding and abetting, and attempts to commit market manipulation, but wrongful intent should be a necessary ingredient;**
- **Language should be consistent with the Regulation; and**
- **Non-EU governments and central banks should be exempted;**

2. Support mandated application of criminal offences

However, we believe only the more serious misbehaviours should be subject to the criminal process;

The burden of proof will be on the prosecution to prove wrongful intent; and

Competent authorities are afforded some degree of enforcement discretion (particularly when the misbehaviour is minor, whether intended or not).

3. Support the introduction of inciting, aiding and abetting, and attempts to commit market manipulation.

However it should be expressly stated that wrongful intent is a necessary ingredient

4. Language should be consistent with the Regulation

Recital 3 provides that "there should also be equal, strong and deterrent sanction regimes against all financial crime". We consider that this should be consistent with the wording in the Regulation and Explanatory Memorandum to the Directive, to provide that sanctions should be "effective, proportionate and dissuasive".

5. Non-EU governments and central banks should be exempted

This would ensure that these are exempted in the same way as comparable EU bodies, particularly where they are trading for comparable purposes in similar circumstances.

Annex 1

Scenario 1 – Oil producer pipeline shutdown

An oil producer which also carries out trading in financial instruments and derivatives on commodities by way of hedging learns of a problem with one of its pipelines resulting in the shutdown of the supply. This would give rise to an exposure as a result of having to buy in additional supplies to meet obligations. The oil producer is under no primary legal or regulatory obligation to disclose the information under EU, national or market rules but is unsure whether the information may be deemed to have a significant effect on the price of relevant instruments if it were made public (Article 6.1 (b) MAR). In the absence of certainty and/or guidance, the oil producer may take the view that this information may be inside information under the new definition, in which case, it would be unable to trade on the basis of this information, and to hedge the exposure caused by the pipeline shutdown.

Even where the oil producer was sure that the information would not have a significant effect on price, it may also be prevented from dealing on the information by virtue of the wider "sweep up" wording in Article 6.1 (e) MAR which prevents dealing where such information would be deemed to be by a reasonable investor "as relevant when deciding the terms on which transactions" in the relevant oil contracts should be effected. It may be argued that the information would be "relevant" to those in the market, again preventing the affected party from hedging its exposure. In practice, the "relevance" test is very hard to satisfy without guidance as to material significance of information.

Scenario 2 - Large scale energy user receives significant new business order resulting in increased demand

A large scale manufacturer and energy consumer wins a new contract which will involve significant additional working hours for its factories in a particularly energy intensive manufacturing process. The manufacturer will require significant additional monthly supplies of energy to ensure the factories work to capacity and meet the demand. The manufacturer chooses to hedge its exposure to changes in energy costs to cover its increased requirements by way of related derivatives transactions.

As in the previous example, could the information relating to the new contract and the subsequent significant increase in the manufacturer's energy demands be deemed to be inside information, either because it could have a significant effect on price, or if a regular user of the relevant market would consider such information to be relevant when deciding the terms on which related transactions should be entered into? Should the manufacturer be prevented from what it considers is legitimate commercial hedging of a new exposure?

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APPENDIX 1 LIST OF FOA MEMBERS

FINANCIAL INSTITUTIONS

ABN AMRO Clearing Bank N.V.
 ADM Investor Services International Ltd
 Altura Markets S.A./S.V
 Ambrian Commodities Ltd
 AMT Futures Limited
 Bache Commodities Limited
 Banco Santander
 Bank of America Merrill Lynch
 Banca IMI S.p.A.
 Barclays Capital
 Berkeley Futures Ltd
 BGC International
 BHF Aktiengesellschaft
 BNP Paribas Commodity Futures Limited
 BNY Mellon Clearing International Limited
 Capital Spreads
 Citadel Derivatives Group (Europe) Limited
 Citigroup
 City Index Limited
 CMC Group Plc
 Commerzbank AG
 Crédit Agricole CIB
 Credit Suisse Securities (Europe) Limited
 Deutsche Bank AG
 ETX Capital
 Fortis Bank Global Clearing NV - London
 GFI Securities Limited
 GFT Global Markets UK Ltd
 Goldman Sachs International
 HSBC Bank Plc
 ICAP Securities Limited
 IG Group Holdings Plc
 JP Morgan Securities Ltd
 Liquid Capital Markets Ltd
 Macquarie Bank Limited
 Mako Global Derivatives Limited
 MF Global
 Marex Financial Limited
 Mitsubishi UFJ Securities International Plc
 Mizuho Securities USA, Inc London
 Monument Securities Limited
 Morgan Stanley & Co International Limited
 Newedge Group (UK Branch)
 Nomura International Plc
 ODL Securities Limited
 Rabobank International
 RBS Greenwich Futures
 Royal Bank of Canada
 Saxo Bank A/S
 S E B Futures
 Schneider Trading Associates Limited
 S G London
 Standard Bank Plc

Standard Chartered Bank (SCB)
 Starmark Trading Limited
 State Street GMBH London Branch
 The Bank of Nova Scotia
 The Kyte Group Limited
 Tullett Prebon (Securities) Ltd
 UBS Limited
 Vantage Capital Markets LLP
 Wells Fargo Securities International Limited
 WorldSpreads Limited

EXCHANGE/CLEARING HOUSES

APX Group
 CME Group, Inc.
 Dalian Commodity Exchange
 European Energy Exchange AG
 Global Board of Trade Ltd
 ICE Futures Europe
 LCH.Clearnet Group
 MCX Stock Exchange
 MEFF RV
 Nasdaq OMX
 Nord Pool Spot AS
 NYSE Liffe
 Powernext SA
 RTS Stock Exchange
 Shanghai Futures Exchange
 Singapore Exchange Limited
 Singapore Mercantile Exchange
 The London Metal Exchange
 The South African Futures Exchange
 Turquoise Global Holdings Limited

SPECIALIST COMMODITY HOUSES

Amalgamated Metal Trading Ltd
 Cargill Plc
 ED & F Man Commodity Advisers Limited
 Engelhard International Limited
 Glencore Commodities Ltd
 Koch Metals Trading Ltd
 Metdist Trading Limited
 Mitsui Bussan Commodities Limited
 Natixis Commodity Markets Limited
 Noble Clean Fuels Limited
 Phibro GMBH
 RBS Sempra Metals
 Sucden Financial Limited
 Toyota Tsusho Metals Ltd
 Triland Metals Ltd
 Vitol SA

ENERGY COMPANIES

ALPIQ Holding AG
 BP Oil International Limited
 Centrica Energy Limited
 ChevronTexaco
 ConocoPhillips Limited
 E.ON EnergyTrading SE
 EDF Energy

EDF Trading Ltd
 International Power plc
 National Grid Electricity Transmission Plc
 RWE Trading GMBH
 Scottish Power Energy Trading Ltd
 Shell International Trading & Shipping Co Ltd
 SmartestEnergy Limited

PROFESSIONAL SERVICE COMPANIES

Actimize UK Ltd
 Ashurst LLP
 ATEO Ltd
 Baker & McKenzie
 Barlow Lyde & Gilbert
 Berwin Leighton Paisner LLP
 BDO Stoy Hayward
 Clifford Chance
 Clyde & Co
 CMS Cameron McKenna
 Complinet
 Deloitte
 Dewey & LeBoeuf LLP
 FfastFill
 Fidessa Plc
 FOW Ltd
 Freshfields Bruckhaus Deringer
 Herbert Smith LLP
 International Capital Market Association
 ION Trading Group
 JLT Risk Solutions Ltd
 Katten Muchin Rosenman Cornish LLP
 Kinetic Partners LLP
 KPMG
 Mpac Consultancy LLP
 Norton Rose LLP
 Options Industry Council
 PA Consulting Group
 Progress Software
 R3D Systems Ltd
 Reed Smith LLP
 Rostron Parry Ltd
 RTS Realtime Systems Ltd
 Sidley Austin LLP
 Simmons & Simmons
 SJ Berwin & Company
 SmartStream Technologies Ltd
 SNR Denton UK LLP
 Speechly Bircham LLP
 Stellar Trading Systems
 SunGard Futures Systems
 Swiss Futures and Options Association
 Traiana Inc
 Travers Smith LLP
 Trayport Limited