



## Commodity Markets Council – Europe

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## CRD4/CRR: transitional measures for commodity market participants

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### 1. Commodity Dealer exemptions

Investment firms whose main business consists exclusively of the provision of investment services or activities in relation to commodity and exotic derivatives (“**Commodity Dealers**”) are exempted from the Part III own funds requirements and the Part IV large exposures provisions of Regulation (EU) 575/2013 on prudential requirements for credit institutions and investment firms (**CRR**).<sup>1</sup> These Commodity Dealer exemptions are temporary and will expire automatically on 31 December 2017.

From 1 January 2018 and without amendments to the CRR provisions, Commodity Dealers will be required to hold regulatory capital equal to at minimum 8% of total risk exposures, rising to 10.5% with the inclusion of the capital conservation buffer.<sup>2</sup> Commodity Dealers will also be required to calculate and report exposures to counterparties equal to or greater than 10% of the investment firm’s eligible capital. Commodity Dealers will be prohibited from incurring exposures to a counterparty or group of counterparties exceeding 25% of eligible capital or EUR 150 million.<sup>3</sup>

Applying own funds requirements on a consolidated basis would add between EUR 50 and 500 million in compliance and risk management costs for each Commodity Dealer. Applying large exposure limits would oblige Commodity Dealers to restructure trade financing and risk management activities, substantially increasing their costs of capital and margin requirements. The combined effect of requirements would drive Commodity Dealers from European commodity derivative markets with consequent and dramatic reduction in market liquidity and quality. The costs of requirements would be passed by remaining Commodity Dealers to other market participants and ultimately to consumers.

### 2. Prerequisites for a new Commodity Dealer regime

CMCE does not believe that own funds requirements or large exposure restrictions are appropriate for commodity market participants that deal on own account in commodity derivatives primarily to manage the risks of their commercial activity and treasury financing activity. Non-bank commodity market participants pose no systemic risk. Most market participant positions in commodity derivatives are fully margined, guaranteed by general clearing members and cleared by central counterparties – measures which would minimise the market effects were a commodity market participant to fail. Additional own funds to absorb losses are unnecessary. Large exposure limits would in effect prevent group-level risk management. Liquidity coverage requirements are irrelevant for commodity market participants that do not transact with retail investors.

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<sup>1</sup> Article 493 and Article 498 CRR.

<sup>2</sup> Article 92 CRR and Article 129 of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (**CRD 4**).

<sup>3</sup> Article 395 CRR.

In any case CRR neither mandates nor foresees the application of own funds requirements and large exposures limits to commodity markets participants. Indeed, Articles 493 and 498 CRR direct the European Commission to report to the European Parliament and the Council by 31 December this year on:

- (a) An “appropriate” prudential supervision regime for Commodity Dealers; and
- (b) A separate category of “investment firm” under Directive 2004/39/EC on markets in financial instruments (MiFID) for persons whose main business is the provision of investment services and activities in relation to commodity and exotic derivatives “relating to energy supplies, including electricity, coal, gas and oil”.

The legislation directs that the Commission may propose amendments to CRR on the basis of the above report. We believe that any such report and/or proposal to amend CRR would require the following:

- Quantitative impact assessment on applying own funds requirements to Commodity Dealers;
- Costs and benefits analysis of applying large exposure limits to Commodity Dealers;
- Review of mark-to-market method for physical commodities and commodity derivatives;
- Review of scope, aggregation and netting of positions for assessment of commodities risk;
- Assessment of standardised approach and suitability for current and prospective Commodity Dealers;
- Analysis of external credit assessment institution coverage of commodity market participants;
- Assessment of current and prospective Commodity Dealers’ access to internal models;
- Analysis of physical commodities as eligible collateral for credit risk mitigation;
- Review of categorisation of physical commodities for extended maturity ladder approach;
- Analysis of effects on costs for non-financial entities transacting with Commodity Dealers;

We believe the above requirements to be necessary for any report under Article 493 and Article 498 CRR. We consider it impractical for the Commission to complete the above requirements by the end of 2015, especially given the many other Part 10 CRR review and reporting provisions.

### 3. MiFID 2 and Commodity Dealer numbers

Most market participants that deal on own account in commodity and exotic derivatives are exempted from authorisation requirements under Article 2(1) of Directive 2004/39/EC on markets in financial instruments (**MiFID**). Consequently, relatively few market participants are today authorised as investment firms and avail of the Commodity Dealers exemptions in the CRR legislation.

However, the Article 2(1) exemptions in the recast Directive 2014/65/EU on markets in financial instruments (**MiFID 2**) are materially restricted. Further changes to MiFID 2 Annex 1 Section C expand the definitions of “financial instrument” and “commodity derivative” for the purposes of that and related legislation. The effect of these changes will be that relatively few market participants that deal on own account in commodity and exotic derivatives will be able to avail of an exemption to authorisation under MiFID 2, even where these market participants transact in derivatives predominantly to hedge the risks of their commercial activities. Most market participants that elect to provide investment services or engage in investment activities in commodity and exotic derivatives from 2017 must seek prior authorisation as an investment firm.<sup>5</sup>

Many of these new investment firms will be subsidiaries of non-financial groups active in the physical commodity markets. Most of these new investment firms will be Commodity Dealers exempted from CRR Part III own funds requirements and the Part IV large exposures provisions until 1 January 2018 when

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<sup>5</sup> The Article 2(1)(j) MiFID 2 exemption for ancillary activity is expected to be applied on the basis of a three-year rolling average, whereby market participants that are unable to avail to the exemption will only seek authorisation in the course of 2018.

these exemptions expire. CMCE anticipates at least a five-fold increase in the number of Commodity Dealers from January 2017 when the MiFID 2 legislation applies.<sup>6</sup>

We believe that any amendments to CRD 4 and CRR regarding an appropriate prudential supervision regime must be based on application of the Commodity Dealer exemptions from 3 January 2017 to 2 January 2019 and must consider the market-wide effects of the application of relevant MiFID 2 provisions.

#### **4. The way forward**

CMCE opposes the application of own fund requirements and large exposure limits to Commodity Dealers. Such requirements are unnecessary and impractical and will add only significant cost for no systemic or market risk benefit. We do not expect any major jurisdiction to follow the EU in imposing regulatory capital requirements on commodity market participants and we fear that the ill-considered application of regulatory capital requirements will drive participants and liquidity from Europe's commodities markets.

In any event, we do not believe that the Commission has sufficient time to devise an appropriate prudential supervision regime for Commodity Dealers, propose corresponding amendments to the CRD 4 and CRR legislation and for those amendments to be adopted before the Article 493 and Article 498 CRR exemptions expire in 2017. We urge the Commission to propose amendments to the CRR legislation to extend the current exemptions to 2020. We believe such amendments would provide sufficient time for the development and application of a tailored regime for Commodity Dealers. We believe such amendments are necessary to avoid safeguard European commodity derivatives markets and should, where possible, be included in legislation already before the Council and European Parliament.

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#### **About the Commodity Markets Council – Europe**

The Commodities Markets Council – Europe (**CMCE**) is an industry group bringing together commercial market participants active across agriculture, energy and soft commodities as well as metal markets. It includes producers, merchandisers and end-users, leading global trading venues for commodity derivative contracts and price reporting agencies.

CMCE promotes effective regulation for physical commodity and commodity derivative markets that reflects the key functions of these markets and that is consistent and effective across jurisdictions. To find out more view our website on: [www.commoditymkts.org/cmc-europe](http://www.commoditymkts.org/cmc-europe)

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<sup>6</sup> As investment firms, these Commodity Dealers will upon authorisation be subject to initial capital, prudential supervision, remuneration and country-by-country reporting requirements under CRD 4 in addition to CRR Part 8 disclosure requirements.

## Annex 1 – Proposed amendments to CRR to be included in [proposed Benchmarks Regulation]

<p style="text-align: center;"><i>Article 493</i></p> <p style="text-align: center;"><b>Transitional provisions for large exposures</b></p> <p>1. The provisions on large exposures as laid down in Articles 387 to 403 shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC and to whom Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field did not apply on 31 December 2006. This exemption is available until 31 December 2017 or the date of entry into force of any amendments pursuant to paragraph 2 of this Article, whichever is the earlier.</p> <p>2. By 31 December 2015, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the European Parliament and the Council on:</p> <p>(a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;</p> <p>(b) the desirability of amending Directive 2004/39/EC to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC relating to energy supplies.</p> <p>On the basis of this report, the Commission may submit proposals for amendments to this Regulation</p>	<p style="text-align: center;"><i>Article 493</i></p> <p style="text-align: center;"><b>Transitional provisions for large exposures</b></p> <p>1. The provisions on large exposures as laid down in Articles 387 to 403 shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9, 10 and <del>10-11</del> of Section C of Annex I to Directive <del>2004/39/EC</del> <b>2014/65/EU</b> and to whom Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field did not apply on 31 December 2006. This exemption is available until 31 December <del>2017</del> <b>2020</b> or the date of entry into force of any amendments pursuant to paragraph 2 of this Article, whichever is the earlier.</p> <p>2. By 31 December <del>2015</del> <b>2017</b>, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the European Parliament and the Council on:</p> <p>(a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;</p> <p>(b) the desirability of amending Directive <del>2004/39/EC</del> <b>2014/65/EU</b> to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9, 10 and <del>10-11</del> of Section C of Annex I to Directive <del>2004/39/EC</del> <b>2014/65/EU</b> relating to energy supplies.</p> <p>On the basis of this report, the Commission may submit proposals for amendments to this Regulation</p>
<p style="text-align: center;"><i>Article 498</i></p> <p style="text-align: center;"><b>Exemption for Commodities dealers</b></p> <p>1. The provisions on own funds requirements as set out in this Regulation shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC and to whom Directive 93/22/EEC did not apply on 31 December 2006.</p> <p>This exemption shall apply until 31 December 2017 or the date of entry into force of any amendments pursuant to paragraphs 2 and 3, whichever is the earlier.</p> <p>2. By 31 December 2015, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the European Parliament and the Council on:</p>	<p style="text-align: center;"><i>Article 498</i></p> <p style="text-align: center;"><b>Exemption for Commodities dealers</b></p> <p>1. The provisions on own funds requirements as set out in this Regulation shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9, 10 and <del>10-11</del> of Section C of Annex I to Directive 2004/39/EC <b>2014/65/EU</b> and to whom Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field did not apply on 31 December 2006.</p> <p>This exemption shall apply until 31 December <del>2017</del> <b>2020</b> or the date of entry into force of any amendments pursuant to paragraphs 2 and 3, whichever is the earlier.</p> <p>2. By 31 December <del>2015</del> <b>2020</b>, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the European Parliament and the Council on:</p>

<p>(a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;</p> <p>(b) the desirability of amending Directive 2004/39/EC to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC relating to energy supplies, including electricity, coal, gas and oil.</p> <p>3. On the basis of the report referred to in paragraph 2, the Commission may submit proposals for amendments to this Regulation.</p>	<p>(a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;</p> <p>(b) the desirability of amending Directive 2004/39/EC 2014/65/EU to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9, 10 and 40-11 of Section C of Annex I to Directive 2004/39/EC 2014/65/EU relating to energy supplies, including electricity, coal, gas and oil.</p> <p>3. On the basis of the report referred to in paragraph 2, the Commission may submit proposals for amendments to this Regulation.</p>
<p style="text-align: center;"><b>Justification</b></p> <p>The above amendments would extend the limited exemptions for so-called Commodity Dealers by 36 months and update the Article 493(2)(b) and Article 498(2)(b) references. The extensions to the exemptions would provide sufficient time for the European Commission to (a) assess the impact of applying own funds requirements and large exposures provisions to investment firms, (b) estimate the number of investment firms affected by the end of the exemptions following application of Directive 2014/65/EU on markets in financial instruments (MiFID 2), (c) report to the European Parliament and the Council on an appropriate regime for the prudential supervision of current and future Commodity Dealers, and (d) as deemed necessary, propose further amendments to CRR to apply a new regime for the prudential supervision of Commodity Dealers. The amendments to Articles 493(2)(b) and 498(2)(b) would preserve the Commission's discretion regarding a new category of investment firm under the MiFID 2 legislation as well as including within any new category persons that provide investment services or activities in relation to emission allowances. The amendments are necessary as powers delegated to the Commission under Articles 456 and 457 CRR do not permit the extension of exemptions. The amendments are consistent with and proportionate to the objectives of the legislation.</p>	