



Commodity Markets Council - Europe

C/O Norton Rose Fulbright LLP
3 More London Riverside
London SE1 2AQ
United Kingdom

Tel: +44 (0)20 7444 5693; +32 (0)2 237 6140
Fax: +44 (0)20 7283 6500; +32 (0)2
Eml: conor.foley@nortontrosefulbright.com
Wb: www.commoditymks.org

10 June 2016

Tilman Lueder
Head of Unit C3 - Securities Markets
DG Financial Stability, Financial Services and Capital Markets Union
European Commission
Rue de Spa 2
BE - 1000 Brussels

Amendments to draft RTS 20 (Ancillary Activity exemption)

Dear Tilman,

I am writing to you on behalf of the Commodity Markets Council – Europe (**CMCE**) and regarding amendments to draft regulatory technical standards (**RTS**) for Article 2(4) of Directive 2014/65/EU on markets in financial instruments (“MiFID 2”) proposed by the European Commission (“draft RTS 20”).

CMCE is an industry group bringing together commercial market participants active across agriculture and soft commodity, energy, base and precious metals and environmental markets. The group includes commodity producers, merchandisers and consumers, the main commodity trading venues and price reporting agencies. CMCE advocates effective regulation that facilitates the key role of these markets in price discovery and risk management.

Many CMCE members will seek to avail of the Article 2(1)(j) MiFID 2 exemption. We note the European Securities and Markets Authority (**ESMA**)’s opinion and proposed amendments of 30 May (ESMA/2016/730). As the Commission considers the options presented by ESMA in its opinion, we offer the following suggestions:

1. Practical capital based assessment

We support the Commission’s view on using a capital based test as a means of determining the relative size of non-privileged trading activity.

i. Denominator

We strongly oppose any effort to restrict the denominator calculation to “EU only” activities, investments or other metric. We see no basis in the legislation for such restriction and we believe that any such restriction would be directly contrary to the definition of “group” provided in Article 4(1)(34) of MiFID 2 and the direction to ESMA in the fifth sentence of Article 2(4) MiFID 2.

We generally support a denominator reflecting both total equity and long-term debt which will align with the reference to Capital Employed in Article 2. We consider the term “current” in respect of debt to be understood and commonly applied across the Union. The current denominators proposed by ESMA reflect components of Capital Employed and are, as a result, not in line with the requirements of Level 1.

ii. Numerator

Regarding the options proposed by ESMA for the capital employed assessment, we favour the use of net marked-to-market values of non-privileged positions in commodity derivatives, emission allowances and derivatives thereof (numerator). We note that the use of net marked-to-market derivatives positions has been reflected in option C of ESMA's opinion. However, we are disappointed that ESMA effectively discourages the Commission from using this option by providing, in our view, inaccurate reasoning. We are of the opinion that net marked-to-market calculation provides a reasonable and reliable measure of non-privileged trading activity, regardless of its numerical value.

Of the other numerator options offered by ESMA, CMCE members could support option D with a factor to adjust for OTC derivative transactions (which constitute a very small proportion of transactions for most commodity market participants). We respectfully disagree with ESMA's reasoning that the inclusion of margins posted for OTC transactions would create incentives to avoid exchange-traded and centrally cleared derivatives. We believe this assessment ignores more relevant incentives for on-venue trading and clearing.

CMCE members therefore support option E (or a combination of options D and E). However, we caution that the analysis provided by ESMA lacks sufficient legal certainty as it is based on draft technical standards not yet adopted by the Commission.

Finally, CMCE members are of the opinion that both options A and B provide no practical solution to the capital based test. Option A is entirely unrelated to capital and thus not an appropriate metric. Option B in our view presents an over-simplified approach that may result in a relatively high number compared to results obtained when using one of the more sophisticated methods. We note that the methodology proposed under option B has been based on the Article 360 CRR, which is one of three options for credit institutions and investment firms in calculating own fund requirements (OFRs) for commodities exposures. The other options under Article 359 and 361 CRR provide for an approach based on the maturity ladder and in practice almost all banks and large investment firms use one of those options to obtain more realistic results.

2. Phased application of the exemption

We would also like to reiterate the concerns of our members regarding the retrospective application of the assessments of the exemption over a 12 month period as opposed to the intended 36 month period. The practical impact of this compressed assessment period may be that market participants will be in exempt in the first year of assessment and not in the second or vice versa creating a disorderly transition from MiFID I to II.

We do not expect draft RTS 20 to be adopted before the end of June. We expect the draft legislation to be subject to an extended scrutiny process and we do not expect relevant ESMA guidance to be agreed before the end of Q1 2017. We consider it entirely inappropriate to apply assessments retrospectively and we fear that any attempts to do so risk placing commodity market participants in legal limbo come 03 January 2018 and application of the legislation. We believe there is more than sufficient legal basis to treat persons eligible to avail of the exemption as provisionally exempt from 03 January 2018 pending confirmation of their meeting the conditions of exemption over a three-year assessment period starting in 2018.

Alternatively we believe that the Commission should adopt an approach similar to that taken by colleagues on amendments to draft RTS on transparency requirements in respect of bonds, structured finance products, emission allowances and derivatives ("draft RTS 2") regarding the liquidity assessment for bonds. Using this approach thresholds are set cautiously and scaled over a three year period. In line with our previously submitted drafting suggestions, we support a "cautious approach" to calibration in order to mitigate the risk of a disorderly transition in 2018-9.

3. Amendments to Article 2(4) draft RTS 20

We have on several prior occasions questioned the suitability of the 'proxy approach' proposed by ESMA. We note the amendments to sub-section (4) of Article 2 of the draft RTS. We consider that these amendments would further undermine the calculation as a proxy for measuring the relative size

of non-privileged trading activity. We encourage the Commission to reject these amendments. As stated above the limitation of the denominator to EU activities would be directly contrary to the definition of "group" found in Level 1.

We thank you and your colleagues for your continuing work on these most-important provisions in the MiFID 2 legislation. CMCE members and I remain at your disposal should you or your colleagues would like to discuss in more detail.

Sincerely,

A handwritten signature in black ink, appearing to read 'Jonathan Hill', with a stylized flourish at the end.

Jonathan Hill
Chairman
CMCE Executive Committee