From: Sonja Erica Väisänen
Sent: 12 March 2018 17:19
Cc: cmce@humebrophy.com
Subject: CMCE - Summary of the CMCE-FCA meeting on EEOTC and position limits

Dear Member of the CMCE MiFID Working Group,

Please find below a summary of the meeting which took place last Wednesday, 7 March in London between a number of CMCE Members and 2 representatives of the FCA. CMCE members in attendance included Ian Mulligan (BP), Marc Cornelius (Shell) and Chris Borg from the advisory team (Reed Smith) who met with Paul Willis and Tom Watson (FCA) to discuss position limits issues.

Background:
For context, CMCE members had heard that one or more financial institutions had reported positions to FCA including some "economically equivalent OTC contracts" (**EEOTC**) in the calculation of those positions and the FCA was understood to have accepted those reports. In particular, it was understood that the FCA had not challenged the EEOTC treatment and had treated itself as not in a position to determine EEOTC status one way or another.

The purpose of meeting with the FCA was (1) to understand the basis/policy behind FCA's actions and (2) to make it clear that there would be potentially serious consequences for non-financial members if it became generally understood that FCA treated contracts as EEOTC. CMCE made it clear that there was real risk that more financial institutions would take this position as it was now known that some were doing so.

Key points of the discussion include:

- Paul Willis said this was not strictly limited to the FCA alone; the AMF has not seen any EEOTC, but several other NCAs have, although he would not say which ones.
- **The FCA has seen EEOTC reports on about 35 or 40 contracts across asset classes**, and reported by more than one financial institution. (Paul Willis shared his suspicions that there is commonality between the financial institutions reporting EEOTC to the FCA and to other NCAs.)
- Paul Willis agreed that the FCA were agnostic about the existence of EEOTCs. He felt the firms in question were likely to have had legal advice on the point, but he could not understand how they would make money if they really were selling lookalikes. It was pretty clear that the FCA had not actually reviewed the contracts in question to see how closely they mirrored the trading venue contracts.
- Paul Willis emphasised that the position limits regime is in its teething stages and that informs the FCA's approach. When the FCA sees a report including EEOTC, it is a rarity and they do look into it. The FCA is at that point that they are **investigating** whether the financial institutions are "gaming the system" by including EEOTC to net down their positions. Apparently in these cases some are not, as they were increasing their position, but this does imply that some perhaps do "game the system". However, Paul Willis did not say whether they kept the institutions under continuous monitoring to see if matters changed after that gateway moment.
- Paul Willis asked whether an ESMA Q&A on the interpretation of what would make a contract EEOTC would be helpful to address this issue, but CMCE made it clear that it would likely be most unwelcome and potentially problematic.
- Paul Willis appeared to be content to operate the regime on the basis that a financial might treat a contract as EEOTC and its counterparty or client treat it as not EEOTC, and they both report on their favoured basis. His position appears to be that the **FCA is not taking a view on the EEOTC treatment** and would only step in if there were evidence of abuse. He did not give a clear idea of what would happen then or whether the Enforcement Division would in fact take a view. When we mentioned enforcement, he said the FCA was being facilitative at present.
- CMCE emphasised that the FCA would need to think about the basis on which it could hold apparently contradictory positions simultaneously and suggested that it was important that the FCA made it clear that it was accepting reports in a way which did not corner it into a position

where it is effectively deemed to have taken a view on EEOTC unwittingly. It is not sure this was fully understood.

- Paul Willis takes the view that Level 1 of MiFID II applies position reporting only to authorised investment firms, so **he does not perceive a risk that exempt firms would need to report OTC contracts independently if they were treated as EEOTC**. While CMCE members did not challenge this, it begs the question whether any successor in the role would take the same view.

The FCA also promised it would indicate which limits have changed when a change is made. The recent instance of a contract being listed as having two limits was the result of an IT glitch which should have been rectified by now.

As always, please do not hesitate to be in touch should any questions arise.

Best regards,
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