



CMCE

- 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@nortontrosetfulbright.com
Wb: www.commoditymkts.org

Edwin Schooling Latter
Chair, ESMA Commodity Derivatives Task Force
103 rue de Grenelle
75345 Paris Cedex 07
France

Proposed amendments to draft RTS 20 and 21

Dear Mr Schooling Latter,

I am writing to you on behalf of the Commodity Markets Council – Europe (CMCE) and regarding amendments to draft regulatory technical standards (RTS) for Articles 2(4), 57(3) and (12) of Directive 2014/65/EU on markets in financial instruments (MiFID 2) proposed by the European Commission.

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.

CMCE members will seek to avail of the Article 2(1)(j) MiFID 2 exemption. CMCE members will be subject to position limits for commodity derivatives executed on trading venues and so-called “economically equivalent” OTC contracts (EEOTCs). CMCE members operating trading venues will also be required to apply position limits and position management controls. We note the letters of 14 March from O. Guersent on behalf of the European Commission to S. Maijoor regarding inter alia the draft RTS 20 and 21 of 28 September 2015. As the Commodity Derivatives Taskforce (CDTF) considers amendments to the draft RTS, we offer the following suggestions:

1. Draft RTS 20: Ancillary Activity exemption

The scope of the “trading activity threshold” calculation remains unclear. We are concerned that inconsistent use of “trading venue” (a defined term) may scope in commodity derivative contracts executed on third country markets and platforms within the asset class calculations. We do not believe this to be the intention of the co-legislators. We encourage the taskforce to use clear and concise language that would limit asset class calculations to (a) commodity derivative and emissions contracts executed on an EU trading venue and bilaterally executed derivative contracts to which a person established in the Union is party.

We support the Commission’s position on use of capital employed as a means of determining the relative size of non-privileged trading activity. We have on several prior occasions questioned the suitability of the ‘proxy’ approach and we encourage the taskforce to propose amendments re-introducing a capital employed assessment to determine the relative size of non-privileged trading activity. We note the Commission’s reference to the proxy approach as a comparison of non-privileged trading activity in EU commodity derivatives and group-level trading in commodity derivatives. We consider this to be a misreading of Article 3(4) of draft RTS 20, which clearly states “all contracts in financial instruments”. If the taskforce is to propose retaining the proxy approach for some eligible

persons, it should clarify that non-privileged trading activity in commodity derivatives, emission allowances and derivatives thereof should be measured against group-level trading activity in all financial instruments. This would be a better proxy.

We also support the Commission's proposal to make the capital employed test available to companies that have undertaken significant capital investments in infrastructure, transportation etc as another factor in determining an entity's level of derivatives trading as ancillary activity. We support the Commission's approach of relying not only on the total transaction volume in commodity derivatives as an indication of an entity's ancillary activity.

We also consider a test based on net turnover to be a viable alternative to capital employed. Using the definition of "net turnover" in Article 2(5) of Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings ("Accounting Directive"), an amended Article 3 RTS 20 would require a person seeking to use the exemption to assess the size of non-privileged trading activity by comparing (a) the net turnover resulting from trading in commodity derivatives, emission allowances and derivatives thereof over a defined accounting period minus net turnover from privileged transactions, and (b) the net turnover of the group over a defined accounting period.

Should ESMA prefer this alternative, we propose that Article 3 RTS 20 is amended to introduce a net turnover test. Persons with non-privileged trading activity representing less than 25% of group net turnover would be eligible to use the thresholds in Article 2 RTS 20. Persons with non-privileged trading activity representing more than 25% but less than 50% of group net turnover would be eligible to use 'halved thresholds' (each Article 2(1) threshold x 0.5). Persons with non-privileged trading activity representing more than 50% of group net turnover would be unable to use the exemption as non-privileged trading activity could not reasonably be considered ancillary to that person's main business at group-level.

We note the Commission's reference to a "cautious approach" in the three year period from the application of the technical standards. We ask the taskforce to carefully set the conditions of the trading activity and main business calculations for the period 2018-2021.

2. Draft RTS 21: Position limits regime

We note the Commission's reference to agricultural commodity derivatives and suggestion that some such contracts executed on trading venues in the Union are relatively volatile. We see no evidence to support this assertion and no reason to alter the baseline approach proposed in draft RTS 21. We consider that the current baseline proposal grants national competent authorities sufficient discretion to apply lower limits for more volatile agricultural contracts. If the taskforce considers an amendment to the baseline methodology, we suggest that Article 14 of draft RTS 21 is amended to permit national competent authorities to set limits between 2.5 and 30% of deliverable supply or open interest for agricultural contracts prone to volatility. We support higher limits for less liquid contracts.

We urge caution as regards amendments to the basis for all other months' limits. We support discretion for national competent authorities to decide the appropriate basis for all other months' position limits for contracts executed on trading venues under their supervision. We consider national competent authorities, in consultation with the relevant trading venues and industry participants, best placed to determine the appropriate basis and level of position limits given the characteristics of the derivative contract. We believe that the Article 57(5) MiFID 2 review mechanism will ensure that national competent authorities set and apply position limits consistently and in line with the provisions of draft RTS 21.

We oppose changes to the Article 6 definition of "OTC contracts economically equivalent to commodity derivatives traded on trading venues". We do not agree with the Commission's analysis and we see no benefits for commercial market participants from a broader EEOC definition,

especially where many such participants may be ineligible for a hedging exemption. We consider the any benefit of a broader definition is far outweighed by the risk of inadvertently scoping in to the position limits regime commodity derivative contracts executed on third country markets and platforms.

We are disappointed that the Commission has not suggested amendments to the Article 2(2) definition of "spot month contract". We have on several occasions made clear to the Commission the deficiencies in the definition as well as the costs of applying spot month position limits prior to the beginning of the delivery period. We urge the taskforce to amend Article 2(2) to define the spot month contract as that contract with maturity next to expire within the period for delivery of the underlying commodity.

CMCE members believe that carefully calibrated and proportionate technical standards for Articles 2(4), 57(3) and (12) MiFID 2 are vital for Europe's commodity derivative markets. As detailed above, we believe some Commission suggestions on amendments to draft RTS 20 are sensible and we encourage the taskforce to reflect these suggestions in amendments. However, we believe that some suggestions are not sensible and risk legislative overreach. We encourage the taskforce to reflect on what is good for commodity derivative markets in any amendments to the draft RTS.

I, fellow CMCE members and our external counsel remain at your disposal to provide any additional information on the comments above that might assist you and your colleagues.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Jonathan Hill". The signature is written in a cursive, slightly slanted style.

Jonathan Hill, Chair, Commodity Markets Council Europe