



MiFID II quick-fix commodity proposals (Ancillary Activity Exemption)

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We, the signatory associations, fully **support the European Commission's proposals amending Directive 2014/65/EU (MiFID II) to simplify the Ancillary Activity Exemption (AAE)**, as part of the larger Capital Markets Recovery Package adopted on 24 July 2020. While keeping the same scope of this exemption, the Commission's proposal substantially reduces the complexity of becoming compliant. The proposal is well-balanced as it allows European companies to cover their commercial risks, whilst it continues to fully safeguard the transparency and integrity of commodity markets. This proposal also ensures the liquidity of the EU wholesale commodity markets and supports a recovery of the real economy from the severe economic damage caused by the COVID 19 pandemic.

However, we are very concerned that the EU Parliament's amendment to the AAE will lead to either a reduced scope of companies able to rely on this exemption or make it even impossible to rely on it. The reason is that the EU Parliament proposes to leave it to the discretion of each EU Member State and, consequently, each single national financial regulator as to whether to apply either the current quantitative exemption test or the new qualitative exemption approach, whereas the latter approach shall be subject to an ESMA Regulatory Technical Standard (RTS). This proposal effectively fails to meet the intended simplification of the exemption regime. It will create legal uncertainty and an additional layer of regulation as well as lead to a fragmentation of the uniform applicability of the AAE in the EU.

In addition, the currently applicable version of the AAE contains a quantitative market size test, which does not work for EU27 companies in a Brexit context: ESMA explained in its MiFID II review report on position limits and position management of 1st April 2020¹ that the

¹ MiFID II review report on position limits and position management of 1st April 2020, p. 38-39 (see [link](#))

Brexit “*will have a dramatic impact on the ancillary activity test and more specifically on the market size test*”. ESMA explains in its report that the market size test of the current AAE will no longer function for EU27 firms when the UK leaves the EU (Brexit) and this will expose the concerned EU27 commodity trading firms to the risk of becoming subject to a MiFID II licensing requirement. This will trigger burdensome and costly requirements under financial regulation, such as capital and margining (collateralization) requirements. This outcome would contradict the political aim of the MiFID II quick fix proposal to support a recovery of the real economy from the severe economic damage caused by the COVID 19 pandemic. Ultimately, this would endanger the currently well-functioning commodity market which is needed to support a green recovery of the European economy and the energy transition.

Please find below our detailed comments:

We remain very supportive of the simplification of the AAE under MiFID II as proposed by the European Commission. Under this AAE, commodity firms remain exempted from MiFID II licensing requirements if their own account trading activity and provision of investment services are ancillary to their main business, when considered on a group basis. Signatory associations and their membership welcome the intended simplification as proposed by the EU Commission. Non-financial firms currently exempted are confident that they can continue to rely on the amended AAE.

In our view, any further improvement of the AAE, if co-legislators deem that necessary, should be agreed by the co-legislators and directly embedded in the Level 1 Text of Article 2(1) (j) of MiFID II. Such a political decision does not require the adoption of an RTS to specify the AAE.

The EU Parliament’s amendment to the AAE would cause the opposite effect of a simplification of the AAE. This would lead, depending on the jurisdiction, either to a qualitative or a quantitative test, whilst adding additional complexity through an undefined RTS mandate to ESMA to define qualitative criteria of the ancillary test. It will lead to a more complicated test instead of simplifying it, which is the intention of the Commission’s proposal.

In general, a narrower interpretation or design of the AAE than currently in place would lead to commodity firms currently relying on the exemption having to become MiFID II authorized, despite not having changed the way they conduct their business. The EU Parliament’s suggestion to maintain the current quantitative AAE is equally problematic given the adverse impact of Brexit on the current market size test. We believe the Commission’s intention is to simplify the test rather than to change the current *status quo*.

Narrowing the exemption would lead to several unintended consequences:

- This would reduce the ability for firms to invest in the decarbonisation of the European economy and endanger the long-term goal of the “European Green Deal” of the European Commission. We believe that money tied up in the regulatory capital and margining requirements is much better used in investment in energy infrastructure and decarbonisation projects, to help make the EU energy sector sustainable in alignment with the “European Green Deal”.
- This would put the EU27 commodity firms at a material competitive disadvantage *vis-a-vis* 3rd country firms, as commodity firms outside the EU can perform relatively simple tests and may not be required to be regulated as investment firms, for example, commodity firms in Singapore, the USA, Switzerland and in the UK after Brexit. EU27 commodity firms would have to comply with burdensome and costly requirements under financial regulation, such as licensing, capital and margining/collateralization requirements.
- The current AAE has a Market Size Test at its core. This will need to be revised, especially if, having left the EU, the UK and the EU do not agree upon a relationship for financial services addressing this exemption. ESMA stated in its MiFID II review report on position limits and position management from 1st April 2020 *that it “shares the views expressed by stakeholders on the impact of Brexit on the MiFID II framework for commodity derivatives and the ancillary activity exemption”*. ESMA continues that it, “*strongly encourages the EC to take the opportunity of the earliest possible amendment to MiFID II to review the ancillary*

*activity exemption and the criteria thereof*¹.” The reason is that the size of the UK commodity markets will not count towards the EU27 market size calculations when the UK leaves the EU without any specific arrangement. This means that trading in certain global commodity asset classes (EU Emission Allowances (EUA), metal, oil, coal), which are predominately traded on UK markets (London Metal Exchange (LME) and ICE Future Europe (ICE)), would then not count towards the EU27 market sizes. Accordingly, the remaining EU market size for the concerned commodity asset classes (EUA, metal, oil, coal) will be so low that there is a high probability that EU27 commodity firms’ non-hedging trading activities, especially a few OTC derivative deals, could breach the relevant market size thresholds. This in turn would trigger a MiFID licensing requirement. The EU Parliament’s suggestion to keep the market size test overlooks this important fact and its adverse implications, which would mean that many EU27 real economy market participants would end up having to become authorised under MiFID II.

- Indeed, a change of the *current scope* caused by a narrow interpretation of the exemption is likely to force energy firms to curtail or stop their EU trading activity, or, where possible, to trade *via other international* markets. The consequential fall in liquidity in EU27 commodity and commodity derivatives markets would significantly increase the costs of risk management for the real economy and severely hamper the ability to hedge the commercial risks efficiently. Subsequently, this would expose EU27 commodity traders, as well as the real economy, to increased risks in volatile markets (e.g. COVID-19) and result in higher end consumer commodity (e.g. gas and power) prices.
- Furthermore, damage to wholesale energy markets directly undermines the political aims such as the completion of the internal European energy market. Illiquid wholesale markets would reduce market competition and efficiency in production and retail markets resulting in higher prices for consumers and industry. Higher risk, constrained investment capital and poor market price signals would significantly undermine investment, production and consumption decisions and reduce security of supply.
- All these increased costs and risks come without additional improvement of the risk profile or integrity of the energy and financial markets. Energy wholesale markets are already effectively regulated, transparent and subject to the same high standards of conduct and integrity. In the end, they are not of systemic relevance for the wider financial markets.
- Finally, a narrow understanding of the AAE would, in the end, harm several political aims of the EU, which are to strengthen the competitiveness of the EU commodity markets, to ensure the development of Euro-dominated EU commodity markets and enable firms to support the European Green Deal through sustainable investments.

For these reasons we believe it is of paramount importance that the co-legislators simplify the AAE as proposed by the European Commission while keeping the current scope of the AAE in place to avoid the above-mentioned unintended adverse consequences. Again, we believe that this political decision, including an EU-wide harmonised implementation of the AAE, should be taken by the EU legislators themselves and not be delegated to ESMA.

¹ ESMA’s MiFID II review report on position limits and position management (1 April 2020 – “ESMA MiFID Review Report”), p. 39, nos. 138 and 139.