**CMCE response to the HMT consultation (WMR)**
**24 September 2021**

## Opening comments

CMCE members agree with the aim of the HM Treasury Wholesale Markets Review (**WMR**) to ensure a more effective, proportionate and less burdensome commodity markets regulatory framework in the UK.

We consider that the Wholesale Markets Review is an important step to create better conditions under which market participants operate in wholesale financial markets in the UK. We believe that the UK can, and should, maintain and enhance its international position as a leading centre for wholesale market commodity and commodity risk trading. The UK's expertise in all aspects of commodity derivatives trading infrastructure serves only to underline the opportunity, which when combined with leadership with respect to the energy transition and Green finance/ESG policy, could significantly advance the UK's position as the key hub in the region for global market participants.

Accordingly, CMCE members welcome the WMR initiative as a necessary step in the process of regulatory review required to achieve this end.

We note that this consultation contains proposals which are largely, if not exclusively, focussed on reforms to the UK MiFID II/UK MiFIR regime. We believe that a more holistic review of the regulatory regime is required. For example, while we note and appreciate the WMR's focus on the UK MiFID II perimeter, this does not in itself resolve some of the key problems with the perimeter under the FSMA 2000 (Regulated Activities) Order 2001 (**RAO**). We note two key problems here for your consideration in this context.

First, the RAO perimeter goes beyond the UK MiFID II perimeter in certain areas (especially with respect to physical forward commodity markets) serving (a) to subject international trade in commodities to potential financial regulatory risk, and (b) to introduce systemic risk resulting from regulatory uncertainty as to the character of physical forwards. The test under article 84 of the RAO is a purposive test (requiring case-by-case assessment of individual trades), and it relies heavily on a series of "indicative factors", which have not changed since first introduced under the Financial Services Act 1986. Many of these factors are now somewhat out of date and serve only to increase the uncertainty for physical commodity

market participants seeking to participate in the forward markets. That uncertainty leads to systemic risk, because breach of the general prohibition under the Financial Services and Markets Act 2000 (**FSMA**) can lead to unenforceable contracts.

Second, the interaction between the perimeter under the RAO and the UK MiFID II perimeter is overly complex and confusing, especially for new entrants seeking to establish businesses in the UK commodity trading markets. In particular, we note the complexity arising from the "MiFID Override" (article 4(4) of the RAO) and the various definitions of "specified investment" which change according to whether the firm in question is subject to UK MiFID II (e.g. the definitions of option, future and contracts for differences under articles 83, 84 and 85 of the RAO). All of these present significant challenges for businesses seeking a simply laid out and comprehensible legal framework with which to engage when approaching the UK markets. (We note that, in the post-Brexit era, global commodities businesses now have to consider not only UK MiFID II, but also EU MiFID II, which is subtly different in terms of the scope of its perimeter; to confront them with the need then to grapple with the interaction of the RAO and UK MiFID II is to add an unnecessary layer of complexity and difficulty.) We consider there is a pressing need to revisit this interaction and simplify it, perhaps by recalibrating the scope by reference only to one instrument, e.g. an adapted UK MiFID II.

We understand that not all changes might be achievable in the short run. A clear and effective future framework, that would enable at least the same level of activities the firms have been conducting under the currently applicable framework, would attract commodity market participants to conduct the business in the UK or with UK counterparties.

CMCE Members highlight below the main ideas in response to the questions posed. We would be very keen to engage with the UK authorities to make this review a successful project. We believe that there is a common aim of the UK authorities and the industry to create a comprehensive and effective framework, which would help the markets to support the UK economy in a broader sense while maintaining high regulatory and supervisory standards.

## CHAPTER 6
## COMMODITY MARKETS

### SCOPE

#### Question 65

*Do you think that the scope of the 'commodity derivatives' regime should be narrowed to derivatives that are based on physical commodities?*

#### CMCE answer

CMCE members would welcome further clarification regarding the intention of the proposal to narrow down the definition of "commodity derivatives".

We understand HMT's proposal to be limited to the definition of "commodity derivatives" under article 2.1(30) of UK MiFIR. It is important to observe that this definition serves only limited functions under the UK MiFID II commodity derivatives regime. It is relevant to the potential scope of position limits rules, for example, but its impact on the UK MiFID II perimeter is limited to the scope of the exemptions under articles 2.1(d) and 2.1(j) of UK MiFID II. It does not have any bearing on the definitions of "*financial instrument*" under paragraphs C(5), (6), (7) and (10) of Annex I to UK MiFID II (as found in Sections 5, 6, 7 and 11 of Part I to Schedule 2 to the RAO), which are the key definitions setting the UK MiFID II perimeter for commodity market participants, taken together with the definitions relevant to emissions (under paragraphs C(4) (where relevant to emissions forwards) and C(11), as found in Sections 4 and 11 of Part I to Schedule 2 to the RAO)). It also has no bearing on the UK perimeter under FSMA and the RAO, which for the reasons stated in our opening comments, is in need of review with respect to its application to physical commodities business.

On the narrow question whether the definition of "commodity derivatives" should be narrowed down, it is not clear what if any significant advantage would be achieved by that, but CMCE members are willing and keen to engage with HMT further on this. We note that certain of the underlyings relevant to the C(10) category (as now found in Section 10 of Part I to Schedule 2 to the RAO) are in fact highly relevant to commodity market

participants – e.g. climatic variables and freight. We also note that new products develop in commodity markets, increasingly as a result of measures driven by climate change policy and the energy transition, such as "guarantees of origin" certificates (GOOs) or renewable transport fuel certificates (RTFCs) which are capable of being underlyings for the C(10) category.

On the broader theme of the need to review the commodity derivatives perimeter, as we have noted in the introductory section above, CMCE members strongly support the efforts to enhance the UK's position as a global commodity and commodity derivatives trading hub. We believe that attracting more commodity trading into the UK would increase liquidity, which would benefit the whole market. We also believe that a holistic review of the perimeter, taking into account the relevant RAO categories of "specified investment", the MiFID Override and the unnecessarily complex interaction between the RAO and UK MiFID II is overdue and would present the opportunity radically to improve the clarity and effectiveness of regulation in this area in the UK.

CMCE members would advocate in the context of such a holistic review of the perimeter for a regulatory framework which would not give rise to a more restrictive regime than is currently presented, which simplifies that regime. We would also see real advantages in aligning the RAO perimeter in this area with the UK MiFID II perimeter (as other EEA Member States did when MiFID I was first implemented).

Any change to the scope of the ancillary activities exemption, would need to be properly analyzed in this regard. We would be concerned that if changes resulted in a more restrictive perimeter, as this would increase the risk of business relocation or of liquidity otherwise migrating away from UK markets.

**Question 66**

*Do you think that financial instruments which refer to commodities as a pricing element but are securities in their legal form, should be removed from the regime?*

**CMCE answer**

The CMCE agrees with the proposition to remove those financial instruments from the commodity derivatives regime. These products are typically relevant for market participants other than commodity trading companies. Removing the securitized instruments from the scope would also be consistent with the changes introduced in the EU through the MiFID Quick Fix package. The CMCE members did support this development on the EU side, and we consistently support this approach in the case of the UK regulatory framework.

**Question 67**

| *Do you think economically equivalent OTC commodity derivative contracts should be removed from the commodity derivatives regime?* |
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| **CMCE answer** |
| It is not wholly clear from the WMR CP whether this question relates (a) to "economically equivalent OTC contracts" as defined for the purposes of the position limits regime or (b) to those OTC physical forwards within the meaning of paragraph C(7) of Annex I to UK MiFID II (as now found in Section 7 of Part I to Schedule 2 of the RAO), which meet the "equivalence" test under article 7(1)(a)(iii) of the UK CDR (2017/565) on MIFID II Organisational Requirements (i.e. those which are "…*equivalent to a contract traded on [a UK regulated market, a UK MTF, a UK OTF] or such a third country trading venue, with regards to the price, the lot, the delivery date and other contractual terms…*").<br><br>In either case, however, CMCE is of the view that it would increase certainty and be beneficial to remove the category from the UK MIFID II regime. HMT remarks that it has in practice proven difficult to identify contracts in this category. We agree with that remark (in respect of both categories highlighted above) and agree that as a result these categories have served only to add a degree of legal uncertainty and complexity to the regime.<br><br>CMCE members would welcome further clarification regarding the intention of permitting trading venues to take account of relevant OTC contracts when monitoring markets. We would be concerned if such a possibility would create more burden on the trading venues to create the reporting framework for the participants to report on these contracts. We would be especially concerned if creating such a framework would create an obligation for the trading venues to assess activity in OTC contracts on a pro-active or ongoing basis, as this would imply a significant increase in the IT cost both for the trading venues and the participants. |
| **Question 68** |
| *Are there any other instruments that you think should be deleted from the commodity derivatives regime?* |
| **CMCE answer** |
| CMCE members do not have strong views to share with the HMT. However, one point should be mentioned. As outlined in response to Question 65, we firmly believe that the framework should be sufficiently flexible to ensure that developments with respect to the energy transition and sustainable economy would not be unduly hindered by the financial regulatory perimeter. |

## POSITION LIMITS

### Question 69

*What would be the risks and benefits of transferring responsibility for position limits from the FCA to trading venues?*

### CMCE answer

CMCE members support the idea of transferring the responsibility for position limits/position management to trading venues, provided that the regime transferred to them is cast at a suitable level and is proportionate to their role. We believe that UK trading venues are superbly well-equipped to carry out the key monitoring and risk assessment functions required to ensure market integrity and to address any real risks presented by the build-up of large positions. Managing and addressing such risks is a task more naturally carried out by the trading venues who can reasonably be expected to have a thorough and immediate understanding of the markets in products for which they provide trading facilities.

Subject to oversight by the FCA, we believe that such a regime would enable venues to enhance liquidity in contracts.

### Question 70

*What specific factors do you think should be addressed in the framework of requirements that UK authorities would provide for trading venues?*

### CMCE answer

CMCE members believe that the position limits/position management regime would need trading venues to be given sufficient flexibility to set and operate regimes which suit their particular markets and products. We would caution against a regime under which the FCA were required or expected to set out prescriptive standards or requirements for trading venues in this area. An outcomes-based approach, taking the effectiveness of such arrangements into account in FCA's supervision of the trading venues, may be more appropriate.

The regime should facilitate market developments: it should not create any unnecessary burden for the venues or participants.

The new regime should not unduly result in more onerous obligations, or create more administrative burdens than under the current framework, for market participants seeking to trade on UK trading venues

The trading venues should be able to establish and adapt their own methodologies when establishing accountability levels. They should have full discretion in identifying the markets and periods to which the measures should apply. Trading venues should also have the discretion to establish whether further investigations and information requests are appropriate when an accountability level is breached. (A regime which resulted in the need for continuous investigation and explanation while a position was maintained over a level, for example, could become overly bureaucratic to no policy advantage.)

Ultimately, individual trading venues are most familiar with trading dynamics on their platform, the behaviour of market participants and the intricacies of the commodity markets underlying their derivatives markets, and thus best situated to set the most appropriate methodology. CMCE would therefore recommend that trading venues retain the necessary discretion (i) in setting accountability levels for appropriate products, and (ii) as to whether to take any action (and if so, what) when a level is exceeded.

On the point of the scope of the contracts which should become subject to accountability levels, CMCE members do not regard the EU MiFID II position limits/position management regime as the best starting point. We have reservations about the utility of position limits in “other months” and to limits based on “open interest” rather than “deliverable supply”. We note, by contrast, that the US CFTC regime generally focuses on spot-month limits, as this is where the greatest risk of market squeezes occurs.

**Question 71**

*Do you think that the scope of contracts that are automatically subject to position limits should be limited? If yes, do you think that it should be limited to contracts that are critical or significant, which includes those that are physically settled, and agricultural?*

**CMCE answer**

CMCE strongly agrees that contracts which are financially-settled should not be subject to position limits. The purpose of position limits is to limit the scope for abusive squeezes in products which are physically-settled, so we welcome the proposal to remove financially-settled products from the regime. Similarly, we welcome the proportionate approach proposed, in the limitation to significant/critical contracts, though we would wish to engage further to understand how HMT proposes to assess “significance” or “criticality” for these purposes

We would, however, like to understand the rationale behind the proposal to make *all* agricultural contracts automatically subject to position limits, even where they are neither significant nor critical.

It is not clear why any insignificant or non-critical contracts should be subject to limits at all, regardless of their underlying. (We also note that not all agricultural products relate to food for human consumption.) Some such contracts may not necessarily be sufficiently liquid to function effectively

under a limits regime. New contracts in agricultural products – or contracts newly launched on UK trading venues – might be challenged by the automatic imposition of limits. We have noted that under the previous regime, there was little discernible market benefit in the setting of nominal limits for nascent or illiquid contracts.

We note that market volatility should not be used as measure to automatically include all contracts, because volatility is not an indication of higher market abuse risk. It is often an indication of insufficient liquidity; often it is driven by external factors relating to supply and demand fundamentals.

We would like to explore the option in discussion with HMT to include only those agricultural contracts which might require and benefit from being subject to a limits regime.

**Question 72**

*Do you think that the UK commodity derivatives regime should allow position limits exemptions for liquidity providers?*

**CMCE answer**

CMCE members would support the proposal to allow position limits exemptions for liquidity providers. Alignment with the EU regime in this case would ensure competitiveness of the UK regime.

**Question 73**

*Do you think that the UK commodity derivatives regime should introduce a 'pass through' hedging exemption to enable investment firms to support a wider range of hedging practices?*

**CMCE answer**

CMCE members would support the proposal to introduce a "pass-through" hedging exemption for financial firms to deliver a wider range of risk-mitigation services. This would benefit industrial market participants seeking to obtain hedging solutions from financial firms, while increasing liquidity on trading venues to the advantage of all, increasing the competitiveness of the UK in this sector.

**Question 74**

*Do you think any other activities should be exempt from the regime?*

**CMCE answer**

CMCE is of the view that some consideration might usefully be given to situations where a market participant is brought over a position limit through no fault of their own – e.g., as a result of a sudden drop in open interest. Market participants should not be exposed to potential liability for breach of rules in such situations.

Similarly, it would be useful to consider the operation of the regime in cases where position sizes are altered as a result of mergers and acquisitions of other businesses (whether by a market participant acquiring the derivatives book of another firm or by an exchange).

**Question 75**

*Are there areas of the UK's position reporting regime which could be improved?*

**CMCE answer**

In general, CMCE members would be concerned about any changes which would mean material changes to the reporting systems and processes which they have already developed, as this would imply potential costs. Having materially different regimes across the UK and the EU trading venues would also not benefit the market participants.

Having said that, we would be willing to explore the possibility to reconsider the current requirements for reported positions to be flagged as for hedging or speculative purposes. The data quality resulting from this element of the regime may not be sufficiently high to justify it.

## ANCILLARY ACTIVITIES EXEMPTION

### Question 76

*Do you think that the ancillary activities test (AAT) should revert to a qualitative assessment of the activities performed by a market participant?*

### CMCE answer

The CMCE would not support the introduction of a qualitative test only. CMCE members would strongly advocate that the UK should take a very similar approach to the one recently introduced through the EU MiFID Quick Fix Directive (2021/338/EU) (the "**EU MiFID Quick Fix**"), which the CMCE regards as a suitable and highly-sensible approach.

We very much appreciate – and agree with – HMT's reservations about the way in which the quantitative tests under the historic exemption have operated, and recognize that problem is exacerbated by the UK's exit from the EU. However, we consider the approach adopted under the EU MiFID II Quick Fix, which benefitted from extensive engagement with market participants, to have resolved those issues effectively. Given this, it would be pragmatic and sensible for the UK to consider a similar approach, not least given the potential difficulties for market participants in having to address very different sets of criteria in order to trade in these adjacent markets.

The ancillary activities exemption forms a key part of the regulatory perimeter under FSMA and, therefore, requires more certainty than can be provided by an approach based on qualitative criteria. Qualitative criteria are likely to be incapable of satisfactorily addressing key issues around commodity portfolio optimization, for example, where trading is often for mixed purposes. Qualitative criteria would be subject to interpretative issues and likely result in markets depending on subjective judgements about them.

A quantitative approach (if simplified along the lines taken under the EU MiFID II Quick Fix), however, would cater for all these issues and provide certainty and proportionality within an objective and clear framework.

We would not support an approach based on a return to the MiFID I version of the ancillary activities exemption (article 2.1(i)) without – at the least – the reintroduction of the commodities dealers exemption under article 2.1(k) of MiFID I. Because the MiFID I ancillary activity exemption under MiFID I was so uncertain, the overwhelming majority of exempt market participants relied instead on the commodities dealers exemption under article 2.1(k). Upon the introduction of MiFID II, the commodity dealers exemption was removed and this resulted in the need to redesign

of the ancillary activities exemption, which was not fit for purpose. This led to the development of a quantitative approach for the ancillary activities exemption – to help provide certainty where none previously existed. We agree, the result of that approach was overcomplicated and now presents difficulty in the post-Brexit environment, but we consider the solution is to simplify the quantitative tests.

Finally, we have reservations about the suggestion that FCA might set the qualitative criteria. The scope of the exemption is part of the scope of the criminal offence under the FSMA general prohibition. We would have concerns if this criminal offence could be changed without scrutiny from Parliament.

In conclusion, CMCE members note, considering all the circumstances, that the approach adopted in the EU MiFID Quick Fix solution provides for a clear, sensible and workable test. Therefore, we would suggest that the UK authorities could adopt a solution along the lines of the one set out in the EU MiFID Quick Fix.

**Question 77**

*Do you think that the basis of the AAT should be expected activity, rather than historic activity?*

**CMCE answer**

While we appreciate the helpful sentiment and motivation driving this suggestion, CMCE members would have very serious concerns, if this approach were implemented. As noted, the ancillary activity exemption is a key element in determining the scope of the criminal offence under the FSMA general prohibition. We would have serious concerns about any proposal where a person's exposure to criminal liability under UK law could depend upon a regulator's expectation of what that person might do in the future. That could unintentionally set a dangerous precedent.

We would also have other concerns, including about the uncertainty resulting from an "expected activity" approach. In order to create certainty, the regulator would have to carry out a proactive assessment of expected activity for each firm seeking to rely on the exemption. This would give rise to potentially huge burdens on the regulator (who would have to deal with every industrial entity seeking to use commodity derivatives to hedge its risk) on an annual basis.

We believe the issue which has prompted HMT's suggestion may have been satisfactorily addressed, in any event, by amendments in the EU MiFID II Quick Fix, which modifies the 3-year look-back approach.

**Question 78**

*Do you agree that the annual notification requirement should be abolished?*

**CMCE answer**

Yes, CMCE members support the removal of this requirement at the earliest possible opportunity. CMCE members are aware that industrial and commercial businesses, which use commodity derivatives to hedge their price risk (e.g., transportation companies using fuel derivatives) are often unlikely to be aware of the need to make this notification, in order to activate the ancillary activity exemption. As a result, such firms may be unwittingly in breach of the general prohibition under FSMA, resulting in potential not only for regulator sanctions, but also for third party liability under sections 26ff of FSMA.

While it cannot address third party liabilities, it would also be helpful, if FCA were to issue a no action communication (to apply until the proposals from HMT consultation are finalized) to the effect that it would not seek to take enforcement action against firms merely for failure to notify and that, it would treat such firms as entitled to rely on the exemption where they meet its criteria, without the need to notify. (We note that the FCA provided similar statement in July 2021 in respect of position limits.)

**Question 79**

*Does the continued existence of the separate Oil Market Participant (OMP) and Energy Market Participant (EMP) regimes for commodity derivative market participants serve any meaningful purpose?*

**CMCE answer**

From the perspective of the CMCE members, considering the existing UK regulatory regime, the OMP and EMP regulatory statuses do continue to serve a meaningful purpose. The regimes allow commodity market participants to conduct regulated activities in the commodities markets, as FCA authorised firms, without being subjected to a suite of rules developed for financial firms. The OMP and EMP regimes were developed to modify the FCA Handbook (and its predecessors) so as to make them appropriate for commodity market participants in the energy sector.

If commodity market participants are subject to FCA authorisation requirements under the general prohibition (i.e., if the RAO perimeter is not cut-back to the point where firms would be excluded from the need for authorisation altogether), they will also need a regulatory regime which takes into account the different position and role they play in the derivatives markets.

We note that in main material respects, the RAO perimeter as it applies to commodity derivatives business is currently wider than in other jurisdictions, including the EU. This has the effect that commodity firms which would not require authorisation to carry out their activities abroad, are subjected to the need to obtain FCA authorisation in the UK. Firms in the EEA, for example, which can rely on the MiFID II ancillary activity exemption do not need authorisation in their home jurisdictions to trade commodity derivatives. In the UK, however, the same firms would need to restrict their business so that they could rely on an RAO exclusion or seek FCA authorisation. It is not at all clear whether any truly useful policy objective is served by this state of affairs (which results from a decision when MiFID I was implemented to preserve the pre-MiFID status quo thus retaining the previous RAO perimeter as a layer underneath the new MiFID I perimeter). We do not recall there having been any meaningful public review of that decision, in particular with respect to the commodity derivatives sector. At present, it serves to disadvantage firms which establish themselves in the UK to trade commodity derivatives, as against their European competitors.

In practice, UK energy market firms which encounter this issue, often establish an FCA authorised firm to house their front office trading activity in the commodity derivatives markets. These firms become FCA authorised, but limit their business so that they are brought within FCA's OMP or EMP regimes, attracting a modified treatment under the FCA Handbook of Rules and Guidance. These modifications are necessary because otherwise these energy market firms would be subject to a rulebook designed for financial market firms, which contains many requirements which are neither suited to nor appropriate for oil or energy market participants, which are typically firms from within energy market industrial groups. Such firms primarily trade in the energy markets to hedge and optimise their energy price risk, delivering better value and lower prices to consumers. As recent experience has shown, energy price fluctuations can lead to insolvencies and systemic failure in the energy sector. It is therefore vital that firms in the sector are able to access the derivatives markets efficiently, without being subject to an inappropriate regulatory regime.

Thus, one must tie the question of the continued existence of the OMP/EMP regimes to the question of the scope of the RAO perimeter in future. If (a) the UK MIFID II ancillary activity test and the EU MiFID II test were (broadly) aligned, and (b) the RAO were adjusted to provide that firms relying on the ancillary activity test from UK MiFID II were excluded from the definitions of the relevant "specified activities", this would level the playing field between UK firms and EEA firms in this sector. In that context, one might usefully review the OMP and EMP regimes, but in the absence of such an outcome many UK commodity firms (including non-MiFID and MiFID firms) are FCA authorised and rely on these regimes.

We also note that the utility of the OMP/EMP regimes is greater for non-MiFID firms, where there has been a greater freedom to adapt the FCA Handbook to suit the requirements of such firms and some consideration might be given to enabling the same treatment to apply for MiFID investment firms meeting the OMP/EMP definitions.

**Question 80**

*Do you think that the OMP and EMP regimes should be removed as particular regulatory statuses from the UK's regulatory perimeter?*

| **CMCE answer** |
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| Considering the CMCE response to Question 79 (see above) and the explanation in our response to Question 76 (see above), the CMCE members consider this would depend entirely on a review of the FSMA & RAO perimeter along the lines described in the response to Question 79. In principle, if they are subjected to UK authorisation, energy market firms must be subject to a regime which is suitable for the needs of the energy sector; experience has shown that the OMP/EMP regime help to tailor the rulebook in this way. Without it, firms would be subject to a rulebook designed for financial firms.<br><br>The imposition of prudential capital requirements for OMP firms in particular could have major financial implications for such firms. |
| **Question 81** |
| *Do you think any changes would need to be made to the MiFID II regime, if the OMP and EMP regimes are removed as particular regulatory statuses?* |
| **CMCE answer** |
| It is important for the CMCE members that if the OMP and EMP regulatory statuses were removed, commodity trading firms should be able to continue to conduct their current activities without additional burdens; they should not be subject to a fully-fledged UK regulatory perimeter for investment firms. This is essential so that they can compete with the market participants in other jurisdictions (many of which do not require authorization to trade at all). It would also be in line with the broader policy aim of this review – to attract more business to the UK market, enhancing the UK's position as a global commodity trading hub.<br><br>If firms were to remain subject to UK MiFID II, the UK MiFID II regime would need to be reviewed with commodity firms in mind. This would be an extensive exercise requiring detailed engagement. |

## CHAPTER 9
## CROSS CUTTING ISSUES

### Question 102

*What further steps can UK authorities take to support the wholesale markets sector as we move towards a low carbon economy?*

### CMCE answer

CMCE members support the ambitious efforts of the UK authorities when leading the transition to a sustainable, low carbon economy. We strongly believe that the UK markets would benefit from such a framework paving the way for a sustainable future, that would be coordinated at the international level. Commitment at a global level would ensure a global solution for a global problem.

In particular, we consider the UK EMIR regime should be revisited with this in mind, as it is currently hindering (or at least limiting) the ability of UK energy market firms to provide liquidity to renewable energy products, who need to access the energy deriviatves markets to hedge their price risk. This has direct adverse effects on the liquidity of OTC derivatives markets, the energy transition and the competitiveness of the UK.

The clearing threshold regime under UK EMIR mirrors that under EU EMIR, which is no longer a necessary or useful benchmark for this purpose. In fact, the UK/EU EMIR regimes are more stringent in this respect than those of other G20 jurisdictions. It may help to highlight four key areas of UK EMIR which are problematic in this area.

First, the clearing threshold for commodity derivatives is set at €3bn (as a result of the onshoring of the EU EMIR €3bn requirement). There is no reason why this should be set as a Euro figure and, more importantly, this figure is too low to enable UK energy market firms to provide sufficient liquidity to the growing market for price risk transfer in the renewable energy sector. Where a UK energy market firm enters into a derivative with a renewable energy producer seeking to hedge its risk, that UK energy market firm will likely not be hedging its own risk and, as a result, it would have to include the trade in its clearing threshold calculation. Given that these transactions are often for long durations and high values, they very quickly consume the €3bn headroom available under the UK EMIR clearing threshold. The consequence for firms of exceeding the threshold

(including initial and variation margining requirements) are so onerous and costly, that this effectively presents a very real disincentive to the provision of the kind of market liquidity required to enable and facilitate the energy transition.

Secondly, this problem is exacerbated by the fact the UK EMIR regime (like the EU EMIR regime which it mirrored when it was onshored) calculates the clearing threshold by taking OTC derivatives trading volumes from across the whole of a firm's group, wherever those volumes are incurred. In large multinational groups, with, for example, significant trading operations in the US, this can lead to fimrs being treated as over the clearing threshold without good reason. There is no particular reason to consider that the systemic risk presented by a commodity firm to the UK market is higher or lower because of the activities of another division of its group, particular where that division is in a jurisdiction, like the US, where similar legislation already exists to regulate and manage such systemic risk.

Thirdly, UK EMIR's treatment of intra-group transactions should be reviewed, particularly where such transactions occur in non-financial groups. Commodity market firms often use centralised commodity derivatives trading firms to aggregate risk for the group, so as to provide internal hedges to group companies. These firms trade with the market and then enter into internal hedge trades with their group companies to provide risk management protection to them in their industrial activity. This enables efficient pricing of hedging and optimization activity for commodity groups, resulting in better prices for end consumers. Under UK EMIR (as with EU EMIR), intra-group trades of this nature can be subject to clearing, margining and other requirements, which is not the case in every other G20 jurisdiction which has implemented derivatives market infrastructure legislation in this area. This disadvantages the UK and limits its potential as a suitable place of establishment for such centralized commodity derivatives trading firms. It also limits the ability of UK energy market firms to provide efficient hedges to renewable businesses within their group.

Fourthly, the clearing threshold calculation currently includes intra-group trades, which may not be appropriate for the reasons above, and covers "OTC derivatives". For these purpsoses "OTC derivatives" include derivatives on overseas exchanges, unless the UK has made an equivalence decision for these purposes in respect of the relevant exchange. We note there are still several overseas exchanges which UK firms need to use to manage their risk which have not been granted equivalence decisions yet.

We therefore propose a targeted review of the EMIR framework relating to the clearing and margining obligation for UK non-financial firms, whilst safeguarding the EMIR aims of transparent and safe markets. The aim of this review should be to provide an appropriate framework to develop open, competitive and attractive energy and commodity derivatives markets in the UK, including to facilitate the hedging needs arising from the energy transition.

We propose a substantial increase of the EMIR clearing threshold calculations (including, but not limited to, an increase in the amount of the relevant thresholds; and a substantial reconsideration of the treatment of intra-group trades for non-financial firms under EMIR.