Commodity Markets Council Europe

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CMCE response to the FCA's Quarterly Consultation No 35 (CP 22/4)

About CMCE

Commodity Markets Council Europe (CMCE) is the only association in Europe representing the range of commodity market participants – agriculture, energy, metals and other commodity market participants, benchmark providers, price reporting agencies, and trading venues operating in the European region (UK, EU, EEA, Switzerland and neighbouring countries). The majority of CMCE members use commodity derivative markets to hedge the risks related to their physical activities and assets. CMCE's key purpose is to engage with policymakers and regulators to promote liquid and well-functioning commodity derivative markets in Europe.

1. General comment: Commodity Dealer Exemption Urgently Needed

CMCE appreciates the FCA statement from 14 March regarding Article 72J of the Regulated Activities Order (RAO), which would enable some firms seeking to rely on the UK ancillary activities exemption to carry on their business without obtaining authorisation if there is no data from an EU institution or a regulator to enable them to perform the market share test. Below, you will find the CMCE response to the FCA's questions related to clarifications to PERG and UK RTS 20, which intend to clarify that performing the market share test is not a necessary condition to benefit from the ancillary activities exemption. The FCA also states that firms otherwise meeting the criteria may rely on Article 72J of the RAO where they cannot perform the calculations the test requires.

Our main comment relates to the fact that article 72J does not provide blanket protection to all types of firm which would otherwise need to rely on the ancillary activity exemption. It is limited to providing an exclusion from the activities of "dealing as principal", "dealing as agent" and "arranging deals" under articles 14, 21 and 25 of the RAO. These activities do not map over to cover all the activities/services which are the subject of the ancillary activity exemption. The ancillary activity exemption covers "investment services" (as well as dealing on own account) [1]. It therefore, for example, provides an exemption from

1.
"MiFID Article 2 (Exemptions)
1. This Directive shall not apply to:
…
(j) persons:
(i) dealing on own account, including market makers, in commodity derivatives or emission allowances or derivatives thereof, excluding persons who deal on own account when executing client orders; or
(ii) providing investment services, other than dealing on own account, in commodity derivatives or emission allowances or derivatives thereof to the customers or suppliers of their main business;
provided that:
- for each of those cases individually and on an aggregate basis this is an ancillary activity to their main business, when considered on a group basis, and that main business is not the provision of investment services within the meaning of this Directive or banking activities under Directive 2013/36/EU, or acting as a market-maker in relation to commodity derivatives,
- those persons do not apply a high-frequency algorithmic trading technique; and

the UK MiFID2 investment service of giving investment advice.

A firm relying on article 72J, therefore, and otherwise unable to relay on the ancillary activity exemption for want of market data, would, therefore, be unable to access article 72J or any exclusions subject to the MiFID Override under the RAO to exclude investment advice under article 53. Article 72J is, therefore, only a partial cure for the problem caused by the unavailability of market data.

While the changes proposed to RTS20 are helpful, we are concerned that risks remain both under RTS20 and as a result of the changes not having been brought into effect by or before 1 April 2022 – the formal notification deadline for firms seeking to rely on the ancillary activity exemption under UK MiFID2.

This gives risk to the risk of unenforceability of contracts (under section 27 of FSMA) at a time when commodity market volatility is placing commodity derivatives markets are under stress giving rise to increased default risks for both exchange-traded and OTC contracts. It is therefore essential that the HMT Wholesale Market Review proposal to implement the commodity dealers exemption (i.e. article 2.1(k) of MiFID1) is brought into effect **at the earliest possible opportunity**.

2. Recommendation: Commodity Dealer Exemption implementation to be prioritised

CMCE strongly supports changes as suggested based on the HMT WMR consultation. We refer particularly to the HMT intention to reintroduce the Commodity Dealer Exemption, which was included in the MiFID I framework Article 2(1)(k) and specifically designed for persons trading in commodity derivatives.

For the reasons given above, this should be implemented urgently so as to reduce the unenforceable contract risk currently attendant on commodity derivatives business.

3. FCA Questions (Chapter 2 Ancillary Activities Exemption)

Q2.1: Do you agree with the proposed amendments to PERG 2 and PERG 13?

Q2.2: Do you agree with the proposed amendments to RTS 20?

4. CMCE Response

CMCE is supportive of the proposals set out in Chapter 2 for the ancillary activities exemption and the suggested approach for dealing with the unavailability of recent regulator data for the market share test.

However, apart from the CMCE's general comment above, we would like to express our concerns regarding the amendment of RTS 20, in particular Article 4 of the Annex in Appendix 3 of the QCP.

The QCP proposes to add the underlined wording:

"Article 4

Procedure for calculation

(1) The calculation of the size of the trading activities and capital referred to in Articles 2 and 3 shall be based on a simple average of the daily trading activities or estimated capital allocated to such trading activities, during three annual calculation periods that precede the date of calculation. The calculations shall be carried out annually in the first quarter of the calendar year that follows an annual calculation period. <u>For the purposes of the derogation</u>

- those persons notify annually the relevant competent authority that they make use of this exemption and upon request report to the competent authority the basis on which they consider that their activity under points (i) and (ii) is ancillary to their main business;"

in article 3(2), the calculation of the size of trading activities may use information published by an EU institution or regulator for the last three annual calculation periods for which that information is available."

CMCE Members agree with the added wording and paragraph 2.8 of the QCP, which states that *"firms may rely on the information published by an EU institution or regulator for the last 3 annual calculation periods for which that information is available. For the year 2022, for example, this will mean relying on the data available for the years 2018, 2019 and 2020."*

However, Article 4 now contains a discrepancy between the calculation periods used for the nominator and those for the denominator. For the nominator, a firm uses the three annual calculation periods preceding the date of calculation. For the year 2022, this would be data for 2019, 2020 and 2021.

Using different calculation periods for a firm's own trading size versus the EU and UK market size would not properly reflect a firm's market share during a period, especially if the nominator includes a period of extreme market volatility, such as 2021, but the denominator does not. This discrepancy may result in a firm exceeding the threshold of the ancillary activities exemption, requiring authorisation as investment firm. Had the calculation periods been the same, the firm may have stayed within the threshold and would have been able to make use of the exemption.

5. CMCE Recommendation

CMCE Members recommend amending Article 4 so that both the nominator and the denominator use the same calculation periods, i.e. the three annual calculation periods for which ESMA data is still available.