CMCE response to the FCA´s Consultation Paper CP23/27 Reforming the commodity derivatives regulatory framework

16 February 2024

Opening remarks

CMCE welcomes the opportunity to provide feedback on the FCA's approach to reforming the commodity derivatives regulatory framework.

CMCE agrees with the FCA's goals of promoting fair and proportionate regulation to ensure market integrity and resilience in the commodity derivatives regulatory regime. To achieve this, however, CMCE strongly recommends that FCA (and, if necessary, HMT) revisit the approach to the Ancillary Activity Exemption, which risks materially undermining the legal basis on which UK commodity market participants rely to trade in the global commodity derivatives markets. Such an approach would put UK commodities market participants at a disadvantage to EU and US counterparts and would disincentivise new UK market entrants.

In its response to the questions raised by the FCA, CMCE provides feedback on different proposals, as featured in the CP.

Q1: Taking into account the proposals outlined, do you have any specific comments regarding implementation of the new regime? Please explain your answer.

CMCE answer

A. ANCILLARY ACTIVITY EXEMPTION

CMCE members wish to express serious concern with respect to the proposals on the **Ancillary Activity Exemption (AAE).**

A legally certain and proportionately calibrated AAE is of paramount importance for UK commodity market participants and we request that the FCA takes urgent action with HMT to ensure the FCA has the powers necessary to issue binding rules. UK firms unable to rely on the AAE for commodity or emissions market business, would need to either stop trading, get FCA authorised or relocate. Because of the "MiFID override", this is the case even where they trade as the clients of financial institutions.

The FCA notes in the CP that it understands the importance of legal certainty with respect to the AAE. We agree and would add that without reasonable legal certainty the AAE has no realistic utility and, in the absence of any alternative exemption, this would have potentially damaging consequences for the UK commodity market.

Unfortunately, the FCA's proposed approach is to issue guidance on the Level 1 text rather than to issue rules. Moreover, FCA's proposed guidance is (a) uncertain and vague, and (b) likely to narrow the scope of the AAE, which we understood is not the intention behind the Wholesale Markets Review.

We note that, like others, CMCE engaged with FCA and HMT at earlier stages in the Wholesale Markets Review and had not been made aware, at any stage, of any intention that the AAE would be addressed only through FCA guidance.

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Certainty: Rules not Guidance

The FCA has explained that it considers it has no power to issues rules on the AAE, and that this has limited it to issuing guidance. We therefore urge FCA to engage with HMT as soon as possible to explore whether any of its existing powers can in fact be used (e.g. whether it could use its power to amend the technical standards, combined with a delay to the commencement of the revocation of RTS20 or whether the Designated Activities regime may be utilised). If no such solution is forthcoming, we would urge HMT to consider proposing a new rule-making power for FCA in relation to the AAE or, if need be, that HMT amend the FSMA 2000 (Regulated Activities) Order 2001 (**RAO**) itself.

We see no realistic prospect of guidance providing the level of certainty required and cannot see another solution without FCA and HMT re-engaging with each other and the market on these points.

For further details on this, please refer to the response to Q25.

Timing: Commencement Delay Required for the SI

We note that SI 2023/548, the FSMA 2000 (Commodity Derivatives and Emission Allowances) Order 2023, which removes both article 72J of the RAO and references to RTS20 in the RAO, is set to commence on 1 January 2025. We infer that it is HMT's current intention to commence the revocation of RTS20 at or before 1 January 2025.

We note that the matters highlighted above are unlikely to be resolved in sufficient time to ensure a smooth transition. If the commencement date for these steps is not delayed past January 2025, to allow sufficient time for implementation post resolution of this issue, this risks a cliff edge effect for sections of the UK commodity market.

In order to continue trading under the regime as currently proposed, many firms may need to take steps to address the legal uncertainty. These steps may include restructuring their trading operations or, in theory, seeking FCA authorisation, neither of which are desirable nor proportionate outcomes. Such steps would take 12 months, or more, to implement, so that certain participants may have to cease trading in commodity derivatives for a period, if the commencement of the new regime is not appropriately delayed. Alternatively, if the issue regarding legal certainty is resolved, firms will still require sufficient time to implement any changes to the current test, including setting up new or changing existing systems and processes to run the necessary tests and make necessary applications.

Change of Scope: Market Footprint Test Needed

CMCE welcomes the FCA's decision to seek to reflect, so far as possible within the constraints imposed on it, the approach taken to the AAE under the EU MiFID QuickFix directive (the QuickFix), as only quantitative tests can provide the requisite legal certainty.

We note however that FCA has not included a "market footprint test", like the "de minimis threshold" set out in the QuickFix, in its suggested guidance. The net effect of this is to narrow the scope of the AAE so that some firms which are currently relying on the AAE under the UK MiFID2 regime would not be able to do so under the proposed future regime.

We understand that that FCA considers that it is unable to interpret the term "ancillary" in a manner which is consistent with the introduction of a market footprint test, like the de minimis, and that it is restricted to tests which make comparisons within the business of an entity or group. We consider that interpretation is too restrictive and not supported by the legislative history. We note that with RTS20, as it stood, both before and after the Brexit implementation date, the term ancillary has included a market footprint test (the "market share test") as a matter of UK law since the first implementation of MiFID2 in the UK. We also note FCA's historic leading role in the working group which made recommendations to ESMA on the design of RTS20,

when it was first introduced; so that FCA should have every reason to consider that the introduction of a "market footprint" test was there and is now a legitimate reading of the term "ancillary".

We therefore strongly urge FCA (or HMT) to include a market footprint test, like the de minimis test, in a set of rule-based criteria to determine when trading is "ancillary" for the purposes of the AAE.

In our response below, we provide further feedback on the market footprint test (like the de minimis threshold) and why it is required by a number of firms.

B. POSITION LIMITS/POSITION MANAGEMENT

Position limits: Timeline for implementation should be extended.

We are concerned by the viability of proposed timelines for implementation of new position limit requirements outlined within the CP by the FCA. For, under current proposals Market Participants will only have 75 days to: (i) implement the necessary internal controls to manage the proposed position limit rules for new critical contracts; (ii) potentially apply for any applicable exemptions; and (iii) ensure that positions are managed in line with regime requirements.

Accordingly, CMCE members believe that trading venues and market participants must be given appropriate time to prepare and apply the new requirements as unsuitable compressed implementation time frames could lead to disruption and disorderly markets, contrary to the FCA's policy objectives of an effective position limit/position management regime.

Consequently, please note the more granular response outlining such concerns in response to Q5 below.

Position management controls: UK venues competitiveness must be maintained/increased.

Position limits should only apply to spot month and accountability threshold should only apply to other months, similar to the approach of the CFTC. For other months, a position limit and an accountability threshold achieve the same objective, therefore both are not required; we disagree with the implication that accountability thresholds are only effective if put in place together with position limits. CMCE members believe that the UK regulatory framework should also aim at maintaining or increasing the competitiveness of the UK trading venues, and should not result in a competitive disadvantage to the EU and US where the respective regimes are currently more dynamic and flexible.

Chapter 3 – Scope of the position limits regime

Q2: Do you agree with the approach outlined, including the criteria to assess the criticality of contracts? If not, please explain why

CMCE answer

CMCE members agree in principle with the approach to transition from limits for all commodity derivatives to focusing on "critical contracts" [and related contracts]. They appreciate that the proposed regime offers greater flexibility and is more proportionate, without loss of the controls required to preserve the integrity of UK commodity derivatives markets.

We agree that the factors set out at draft MAR 10.2.1B (1) to (4) are appropriate factors to take into account in assessing criticality. [FCA should also be required to consider, as a fifth factor, why the contract cannot be

appropriately managed under the position management regime or other measures already in place under the rules of the relevant trading venue.]

However, the proposed regime appears to give FCA a wide discretion in determining which contracts are “critical” for these purposes and the comment process provided for should be improved and clarified to address this.

First, the drafting of MAR 10.2.1B ff is confusing: (1) FCA notifies the market by issuing a notice when it “considers” that a contract is critical, but (2) market participants have 45 days to comment on the “proposed determination” and (3) FCA then must consider those “responses” before publishing the outcome of its “consultation”. It should be made clearer that the initial notice is only a proposal and not a determination, and that the comment period is a proper “consultation period”. (FCA should be subject to the usual process requirements as for any consultation, including cost-benefit analysis.)

Second, we would expect FCA in the normal course, to explain in its consultation paper (a) in what sense the contract is “critical” (as there is no defined concept of “criticality” in the proposed rules), and (b) how it has addressed the [four/five] key factors in its proposals. To provide assurance, the rules should expressly require this.

While we understand the FCA's consideration of the challenges in maintaining a timely list update when markets are rapidly changing, CMCE members emphasize the need for a proper consultation process, especially as regards the position management regime to allow for a proportionate response and also for market participants to have sufficient time for implementation.

Q3: Do you agree with the approach outlined with respect to related contracts? If not, please explain why.

CMCE answer

CMCE members agree in principle that certain related contracts should be included in trading venues’ setting of position limits. However, CMCE members consider that the current criteria are too prescriptive and that not all contracts that come within the wide definition currently set out in the draft rules should be included.

Purpose

Related contracts should only be included if, in the view of the relevant trading venue, they might realistically be used to manipulate a critical contract or impact the deliverable supply. CMCE members are of the view that a materiality condition to this effect should be included in the operative provision at MAR 10.2.1A R.

Definition of “Related Contract”

The definition currently covers any commodity derivatives contract traded on a trading venue in the UK that meets one of three conditions. “Commodity derivatives contract” is defined by reference to provisions originating from MiFID and MiFIR, and therefore includes structured products referencing commodities.

Further, the phrase “traded on a trading venue in the UK” does not refer back to the trading venue on which the critical contract is traded (the “primary market”) so it is conceivable that a contract meeting one of the conditions traded on an OTF or MTF would have to be included in position limit established by the primary market. There is nothing in the proposed rules to operationalise cross-venue position limits.

CMCE members also consider that the three conditions are too widely cast, and should all be limited to contracts that could realistically be used to manipulate the critical contract, in line with the purpose described above.

The first condition is that the settlement price be linked to the settlement price of a critical contract. Presumably therefore both contracts based on indices including the critical contract's settlement price as well as spreads would be "related contracts". CMCE members agree with the assessment of the CFTC that these contracts are unlikely to be capable of being used to manipulate a critical contract:

- Contracts based on indices published by price sources which include one or more critical contracts should be excluded or at least be capable of being excluded from the definition.

- The category "inter-contract spreads that include a critical contract" alone has the potential to complicate implementation considerably given the number of spread products listed on relevant trading venues (for example, Brent contracts listed on ICE Futures Europe). There is a risk that the proposals would result in a regime which is much more restrictive than other regimes internationally, and so may impair international competitiveness. The CFTC position limit excludes from the position limit regime spread transactions, defined as "an intra-market spread, inter-market spread, intra-commodity spread, or inter-commodity spread, including a calendar spread, quality differential spread, processing spread, product or by-product differential spread, or futures-option spread."
- [average pricing contracts]

The third condition brings into the definition of related contracts commodity derivative contracts with the same underlying as the commodity underlying the critical contract. CMCE members recommend that the definition should be refined so as to refer not only to the same underlying commodity but to the same specification and the delivery location thereof (if part of the contract specification) as that of the critical contract.

<u>Position Calculations</u>

Finally, the FCA suggests at 3.34 of the Consultation Paper that trading venues might not prescribe the netting of related contracts. This is potentially problematic. If related contracts are not included in the position calculation in the same way in all cases, and instead trading venues have discretion as to how they are to be included, the regime might prove overly complicated for market participants in terms of implementation and maintenance.

For example, if one trading venue permits netting of related contracts and another does not, a market participant trading on both trading venues will have to build two separate systems, each requiring different systems, processes and monitoring, incurring a disproportionate amount of costs and resource to the objective to be achieved.

CMCE members are therefore concerned that the regime may be administratively burdensome and give rise to significant implementation and ongoing operational costs.

Q4: Are there any specific types or classes of contracts that should not be included in the related contract concept? If so, please explain why.

CMCE answer

As set out above, CMCE members express concern regarding the potential scope of the related contract concept.

As presently drafted, the definition is very broad, potentially covering a huge pool of contracts, many of which do not have ability to influence the pricing and settlement of the critical contract, which FCA says at 3.20 is the objective of the "related contract" concept.

Limb (b) which includes any contract that references a critical contract should be removed.

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We note that CFTC equivalent (referenced contracts) excludes Balmos and spreads as they don't have ability to influence price.

The FCA regime for related contracts should enable exchanges to identify contracts that have the ability to influence the pricing and settlement of a critical contract (when aggregating positions for the purpose of setting the critical contract). To illustrate this point,Dated Brent and 1st Line Brent shouldn't be bucketed together to calculate the Brent Futures Contract as they price across separate dates. However, the trading venue should monitor positions in these two contracts as part of its position management framework.

Contracts that are already subject to adequate position limits under another regime (for example, ICE Futures Europe has CME lookalike contracts that are subject to CFTC limits) should not be subject to additional limits under the UK regime.

CMCE members also recommend further consideration as to the implications of the proposals on the introduction of a *new contract* which would automatically qualify as a related contract. Such a contract would be immediately subject to position limits, making it very difficult for it to acquire the liquidity it needs to develop and survive. The current regime had an exception for new and illiquid contracts for this reason. CMCE members suggest either to retain such exemption under the new regime, or to provide for an alternative form of exception whereby such new related contracts are only subject to position limits after an implementation period or of a certain number of months, or after the contract has grown to exceed a specified volume. CMCE members consider that the precise approach should be a matter of exchange discretion in line with the response to Q3 above.

It is noted that the FCA expects a trading venue to provide it with prior notification of its position limit framework, including "the proposed list of related contracts, related OTC contracts and related contracts traded on overseas trading venues". Trading venues will also have to publish "in a clear and accessible manner the list of related contracts for each critical contract."

CMCE members would like to see an obligation on the trading venues to consult market participants on the addition of any related contracts before they are included in the position limit regime, if practicable in the relevant context and circumstances. The proposed process in relation to consultation on critical contracts might also be adopted here.

Q5: Do you agree with the proposed approach to update the list of critical contracts? If not, please explain why.

CMCE answer

The FCA's proposal suggests providing market participants with a 45-day notice period for comments, along with an additional 30-day implementation period for trading venues to establish and apply a new position limit.

CMCE's concerns on this proposal can be summarised as follows:

- The 30-day period would be insufficient to enable appropriate implementation both by the trading venues and by members, and their clients.
- Depending on the contract, trading venues may need considerably longer both to set an appropriate limit and to assess and determine applications for exemptions from market participants.
- Market participants would become aware of the actual level of a limit at some point during the 30-day period, not at the beginning of that period, giving them hardly any time to implement position measurement and control systems across their group and to prepare and submit exemption applications, where relevant.

- In particular, CMCE members could need additional time to (for example) unwind positions over the new limit in an orderly manner. This may need to take effect after a hedging exemption has been processed – firms denied such an exemption would still need time after that to effect an orderly wind down of their positions.

For these reasons, CMCE members recommend that the implementation period should be extended to a period of 45 days for the initial consultation and *a minimum* period of 90 days for trading venues to establish and apply a new position limit, save that trading venues should also be required to take the considerations above into account in setting the implementation period, so that an orderly transition can be assured.

Q6: In notifying us of a particular market that requires closer monitoring, are there any other factors that trading venues should consider? If you think there are, please explain what the additional factors are and why they should be considered.

CMCE answer

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Q7: Do you agree with the list of critical contracts? If not, please explain why.

CMCE answer

CMCE members are broadly in agreement with the FCAs proposed list of critical contracts.

However, CMCE members question the inclusion of the ICE Futures Europe WTI contract in the list of critical contracts. This is a cash-settled contract and therefore simply cannot meet all four of the criteria to which FCA must have regard.

Moreover, CME NYMEX lists a deliverable WTI contract and is subject to CFTC regulation in respect of it. ICE Futures Europe is an FBOT and also subject to CFTC regulation in respect of its WTI contract. To overlay UK position limits on this contract would seem unnecessary and confusing, given the existing regimes to which it is already subject.

The application of UK position limits would lead to the contract having multiple limits and accountability levels for the same contract under different regimes, which would be confusing and unduly burdensome for market participants, potentially impacting market liquidity .

Q8. Should any of the three cash settled contracts mentioned above (Dated Brent Future, Dubai 1st Line Future, Singapore Gasoil (Platts) Future) or the physically settled Permian WTI Future be added to the list of critical contracts? If yes, please explain why.

CMCE answer

No. CMCE members advocate that such contracts should not be added to the list of critical contracts. For cash-settled contracts have a better liquidity so other tools can be used to manage issues other than position limits. The Permian WTI Future contract is not critical to the UK.

Q9: Taking account of our proposals on position management and the reporting of additional information, do you consider that the risks arising from positions held OTC are adequately dealt with despite the fact that position limits do not apply to OTC contracts? If not, please explain why.

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CMCE answer
The majority of CMCE members agree that position limits should not apply to OTC contracts. Trading venues are already able to request relevant information from market participants on such contracts. We note that resource, costs and time would be needed for market participants to implement an OTC reporting regime and it is not clear what additional benefit this would give to trading venues give they already have the right to request such information, and what actions they would take with this information. Furthermore, CMCE members would also raise concerns: (i) around potential disparity within the market with those Market Participants subject to position limits potentially being disadvantaged to those not subject to position limits and (ii) the practicability of legal enforceability of position limits on OTC contracts.
Chapter 4 - Setting position limits
Q10: Do you agree with the approach and framework outlined above for setting position limits? If not, please explain why.
CMCE response
CMCE members note that the framework in general affords a high degree of discretion to trading venues to set position limits. CMCE members agree with the principle, but some are mindful that the relevant trading venues in this context (ICE Futures Europe and LME) are commercial enterprises and are the only UK trading venues for their respective asset classes, and that the framework should therefore manage the conflict between their economic self-interest and their regulatory obligations. CMCE members also note that the application of both accountability thresholds and ceilings for exemptions might add complexity and decrease clarity in practice this would have the effect in practice of imposing multiple limits on a contract. This response should be read in conjunction with CMCE response to Q16.
Q11: Do you agree with the criteria trading venues shall consider when developing their position limit setting methodology and when setting position limits? If not, please explain why.
CMCE response
CMCE members are in broad agreement with the list of factors to which trading venues are expected to have regard when setting position limits and with the methodological indications on how to apply those factors. FCA may wish to consider whether it would be better to express those indications in a less prescriptive manner (the use of the word "should" seems more in keeping with a rule than guidance) so that trading venues retain the ability to set appropriate limits in all circumstances.

Chapter 5 – Exemptions from position limits
Q12: Do you agree with the approach to granting exemptions outlined in the CP? If not, please explain why.
CMCE answer
CMCE members support the general approach to granting position limit exemptions but are unsure what is the purpose of the Exemption Ceilings. CMCE members are concerned about prospect that this is treated

too prescriptively by the trading venues and constitutes a further limit and request clarification as to the purpose of an exemption ceiling and how they would operate.

Furthermore, from a trading venue perspective, the requirement for trading venues to notify the FCA when an exemption ceiling is breached (MAR 10.2.25 R) is unduly burdensome and appears to go against the intent of the reform to devolve powers to trading venues.

Q13: Do you agree with the approach to the hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

CMCE answer

CMCE members note with some concern that FCA proposes to introduce a requirement that, when non-financial firms apply to the trading venue operator for the exemption, they must include information regarding their ability to unwind positions during times of market stress. CMCE members would recommend removal of this condition.

The CP states that firms applying for the exemption must show that their position "*at its estimated highest point in the following year can be unwound, in particular during times of market stress where market liquidity may be constrained, in a way that does not impair orderly markets*".

CMCE members consider that it would be extremely difficult for firms to make or prove these matters in practice, primarily because:

- firms will not be in a position to identify what constitutes "market stress" for the particular market or contract in question – that is a matter for the trading venues to model rather than market participants;
- nor would each firm be working with the same assumption of what amount to market stress, leading to variable and inconsistent application of the exemption;
- firms will not necessarily be in a position to evaluate with any reliability what the estimated highest point of their positions might be in the future, as this could depend on a range of factors not within the firms' control.

Moreover, a firm with a large commercial hedging requirement would be highly unlikely to want to unwind its entire position, including its hedges at times of market stress – that would expose it to price volatility risk at a dangerous time. So it is not clear why FCA wishes to introduce this additional orderly wind-down requirement into the hedging exemption.

CMCE members would ask FCA to give further consideration to the possibility of facilitating a grandfathering mechanism which would enable firms currently relying on hedging exemptions under the present regime to do so under the new regime, without having to re-apply and re-establish its ability to rely on the same criteria. CMCE members are concerned at the potential for a "Big-Bang" application rush when this regime commences.

CMCE members would also like to see a solution similar to the one under the CFTC rules, which addresses trading venue's ability to grant hedging exemptions to deal with emergency situations (e.g. on a member default or force majeure situation).

Q14: Do you agree with the approach to the pass-through hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

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CMCE answer
CMCE members support the introduction of a pass-through hedging exemption for financial firms.
Q15: Do you agree with the approach to the liquidity provider exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.
CMCE answer
CMCE members agree with the proposed approach.

Chapter 6 – Position management controls and reporting
Q16: Do you agree that trading venues should establish accountability thresholds for critical contracts?
CMCE answer
CMCE members are concerned that in practice the accountability levels risk operating as additional hard limits, given the additional reporting burden when exceeding the levels, as per our response to Q18. Therefore, CMCE members do not agree with the proposed approach for establishing accountability thresholds for critical contracts. This type of threshold is well established as a position management control in other markets notably in the US. However they are used to provide control only over products and periods where there are no position limits in effect. Having both accountability thresholds and position limits applicable to the same contract is unnecessary duplication. * The US equivalent of critical contracts are the 25 products subject to Federal position limits. Nine of these, the legacy agricultural products, are subject to position limits for each of the spot period, single month and all month combined positions. These nine are not subject to accountability thresholds at all. The other sixteen are only subject to position limits during the spot period and most have exchange set accountability thresholds for single month and all month combined positions. These thresholds are set at levels higher than the spot period limits (except for ICE Sugar 16 where they are the same). In practice this means that that there is no real overlap between the two. For contracts where a position limit applies, the limit is the regulatory control. For the contracts where the limits do not apply the accountability thresholds are the control. * We believe that this is a sensible and well established approach.
Q17: Do you agree with the approach outlined and the factors that should be considered as part of the trading venues' accountability threshold setting methodology? If not, please explain why.
CMCE answer

CMCE members advocate that annual reviews of accountability thresholds as a matter of course would be operationally burdensome for Market Participants and could potentially impact the market (e.g. position wind downs, internal firm system enhancements) as a result of transition from one threshold to another. Accordingly, CMCE members would support that following a period of establishment of the new regime trading venues should review their accountability thresholds only whenever there is a significant change to the relevant position limit or a change that significantly impacts the prescribed criteria.

Q18: Do you agree with the set of conditions that result in the requirement to provide additional reporting? If not, please explain why.

CMCE answer

CMCE members believe that the consequences of triggering an exemption ceiling, or an accountability threshold are expected to pose a significant burden on market participants, given the additional obligations to report positions in related OTC derivatives contracts and contracts traded on overseas trading venues. On the latter, CMCE members note with concern the potential antitrust implications this measure can entail.

CMCE members perceive a potential risk if market participants may consider exemption ceilings and accountability thresholds as additional, more rigid limits in practice. Concerns about the accountability thresholds are further emphasized by specific aspects of the proposals, including the requirement for trading venues to provide annual notifications to the FCA, identifying market participants causing accountability thresholds to be exceeded. Additionally, references in draft MAR 10.3.3A R to accountability thresholds being "breached" rather than "exceeded" contribute to this perceived risk. Overall, this can eventually cause the creation of a more demanding regulatory environment for market participants, potentially leading them to choose staying under the accountability threshold and creating a de facto additional limit to avoid potential additional reporting, which could impact liquidity.

Q19: Do you agree with the information to be reported once the additional reporting requirement is triggered? If not, please explain why.

CMCE answer

First of all, CMCE members would like to stress that currently, in practice, trading venue operators already have the power to request the provision of additional information if they choose to do so. In the CP we understand, however, that there is an expectation that trading venues not only 'may' but in fact 'must' require the provision of additional information in relevant circumstances. We have a strong preference for the discretion (*may*) at the level of the trading venue instead of the obligation (*must*).

In general terms, most of the CMCE members are concerned regarding the introduction of a formal requirement for market participants to report information on their positions in related OTC derivative contracts and related contracts traded on overseas trading venues to trading venues. There are two main issues with this measure:

- **Competition Law**. For trading venues, information about market participants' activity in the OTC market and on other trading venues represents information about their competitors. There is a significant risk that market participants and trading venues would breach:
    - antitrust laws by reporting their positions on overseas trading venues to competitor UK trading venues; and
    - confidentiality restrictions with respect to disclosure of information from clients.

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We believe that UK trading venues may not be legitimately able to obtain or use commercially sensitive information about their competitors' businesses. Likewise, there is a potential risk that, for specific overseas trading venues, market participants may breach local regulatory requirements by reporting positions without the necessary authorization from the relevant overseas regulator.

- **Practicality**. We also observe that the proposals do not specify a particular format for reporting additional information. Consequently, if trading venues adopt varied format requirements, market participants would need to establish different systems to ensure compliance. This is likely to impose a burdensome process, leading to operational complexity and increased compliance costs for market participants and their clearing members. Such a scenario could also reduce the international competitiveness of UK trading venues.

- We also note that the requirement on firms to ensure they would have "ready access" to such additional information, with respect to themselves and their clients, would require a level of preparation at client onboarding by clearing members on UK exchanges, which is not required elsewhere – the normal requirement is that firms should require clients to co-operate and provide information when required, not that they have to have "arrangements in place to ensure ready access".

We would therefore recommend instead adopting an approach similar to that practiced in the EEA under MiFID2 and in the US, whereby trading venues have the option (but not the obligation) to ask for clarifications or additional information where accountability levels are exceeded. This would also decrease the risk of market participants avoiding UK trading venues for reasons of having a more onerous regulatory framework and trading partners avoiding entering into OTC transactions with counterparties that are a member of a UK trading venue and thus subject to the proposed rules. Such consequence would negatively impact both the ETD and OTC commodity market.

Q20: Do you agree with the definitions of related OTC contracts and overseas contracts? If not, please explain why.

CMCE answer

We make the same observations here for "related OTC contracts" as in relation to the definition of "related contract" in the response to Question 3, in particular that the definition should contain an additional limb setting a "materiality condition" to the effect that the "related OTC contracts" must be realistically capable of being used to manipulate the critical contract or the deliverable supply under it.

For the reasons already given, we are strongly of the view that the concept of "related overseas commodity derivatives contract" is highly problematic and should not be included in the proposed regime.

Q21: Do you consider that additional reporting requirements should apply at a group level rather than entity level for the reasons highlighted in paragraph 6.33 above? If not, please explain why.

CMCE answer

The majority of CMCE members do not agree that additional reporting requirements should apply at a group level, as it would be burdensome and disproportionate to have to obtain information from affiliates. CMCE members note that information on OTC derivatives transactions may also already be reported to the FCA under UK EMIR.

We note that this level of "group" reporting would be to go further than in other regions. In the US for example, it would not be required across groups which are disaggregated for position limits purposes. FCA would need to address considerations like this, if it were to seek to implement "group" reporting on a proportionate basis.

Q22: Do you agree with the proposal for trading venues to develop a periodic market risk analysis report? If not, please explain why.
CMCE answer
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Q23: Do you agree that trading venues are best placed to determine for which contracts CoT reports should be published or do you have views on how the criteria should be amended? Please explain your answer.
CMCE answer
…
Q24: Are there any other changes to the public reporting of aggregated positions that you consider appropriate? If yes, please explain the changes you propose and why they are necessary.
CMCE answer
…

Chapter 7 – Perimeter

Q25: Do you agree with the proposed guidance on the AAT? If not, please explain why.

CMCE answer

We refer you to our answer to Question 1, all of which applies equally here.

Additionally, we would add the following comments.

1. **<u>Market Footprint Test (like the *de minimis exemption*)</u>**

CMCE also have significant concerns about the FCA's decision to restrict the scope of the exemption by excluding the de minimis exemption, which traditionally considers the market footprint of the firm. This decision would in practice entail a real narrowing of the exemption (potentially contradicting one of the principles of the Wholesale Markets Review), forcing several CMCE members who currently rely on this threshold to obtain MIFID authorisation or ultimately relocate in another jurisdiction. Similarly, other smaller firms operating in the market would end up being in a disadvantaged position[1].

[1] *Example:* A small firm that trades on its own account but ultimately has a limited amount of capital. They could have one (or very few) transactions that are not wholly a hedge (i.e. contain a speculative proportion) but that position could very quickly be a multiple of capital given commodity pricing and transaction sizes. This could include an option that typically has a lower transactional cost. *Overly simplified example, but illustrative of the point:*
** ABC Limited has a capital of $5M*
** ABC has a speculative position made up of 100 lots Dec-24 Brent ($80/bbl) and 50 lots Mar-24 LME Aluminium ($2200/mt)*
** Notional of Spec is $8M (Brent) + $2.75M (Ali) and more than double their capital.*

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The EU adopted this test because it was evident that by removing the previous "market share test" the AAE would no longer have a "market footprint test" included and that this would mean it could not be relied on by firms which had been relying on that limb before Brexit. The EU's objective in the QuickFix was to restate the AAE thresholds in a manner which took account of the geographical challenges posed by Brexit (leading to the need to remove the "market share test") without narrowing the scope of the exemption (leading to the inclusion of the "de minimis test", as a substitute market footprint test).
The EU's de minimis test sets a threshold of EUR3bn for certain cash-settled commodity derivatives and emissions contracts.

By not adopting a similar approach and introducing a market footprint test of some kind, FCA would be narrowing the AAE and creating a divergence between the UK and EU regimes, which is (a) unhelpful to market participants operating in both markets and (b) uncompetitive from the UK point of view.

The EUR3bn figure was taken from Art. 10 of EMIR (clearing threshold before the recent raise to EUR4bn in the EU). The reason for using a test similar to EMIR was that corporates are calculating their clearing thresholds already and since the EU's objective was to simplify the AAE, it seemed using a test already carried out by firms would fulfil this objective, although the calculation methodology had to be adapted to align with MiFID II. The purpose of the alignment was to avoid disadvantaging firms relying on different tests under the AAE, i.e. those relying on the new de-minimis threshold test and those relying on the capital employment test, the methodology for both tests is based on the same definition of netting and exclusions.

2. Other Remarks on the Content of the Proposed Guidance

The Guidance introduces multiple factors which it, firms, and, ultimately, the courts would need to take account of in order to assess whether trading activities are ancillary for the purposes of the AAE. Many of those factors are expressed in indefinite terms and there is no clear sense of which factors predominate, introducing an additional level of uncertainty into the inherently uncertain medium of guidance. (We do understand the constraints within which the FCA operates when issuing guidance and recognise that it could not express guidance in the same definitive terms as rules.)

For example, there are references to (a) hedging, in the first paragraph; (b) the first two limbs of the QuickFix tests, in the second and third paragraphs; and (c) an additional undefined set of factors (profits, staff numbers, and time spent on relevant activities) in the fourth paragraph.

The proposed guidance, therefore, does not give a clear interpretation of what amounts to ancillary, and would in fact leave a court, faced with this question, in a position where it felt bound to investigate *all* of these factors before making a determination. In practice, this would mean that *firms* seeing to rely on the exemption would also need to consider *all* of these factors.

The overriding declared intention of this aspect of the Wholesale Markets Review was to "simplify the process" for firms seeking to rely on the AAE (without narrowing down the scope of the exemption). Unfortunately, this guidance (which we appreciate is well-intentioned), not only introduces a high degree of legal uncertainty, but would also make the process of determining whether a firm could rely on the exemption more lengthy and difficult.

Compared to the market, this entity is insignificant (circa 0.05% of OI for Brent and 0.07% of OI for Ali) and presumably of minimal interest to the regulator. It would seem excessive for such an entity to be required to be authorised (especially given the consequences of being unauthorised in the UK).