



European Securities and  
Markets Authority

10 July 2014 | DG Agri Expert Group, Brussels,

## MiFID II: so what are ESMA's proposals?

**Catherine Sutcliffe**



- **How we got here**
- Scope of MiFID II
  - Ancillary activity
  - Definition of financial instruments
- Position control framework
  - Position limits
  - Position reporting
- Transparency and liquidity

# Pre-MiFID: Investment Services Directive

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Instruments

Shares



Alternative  
trading  
systems

Trading Venues

Off Venue Trading

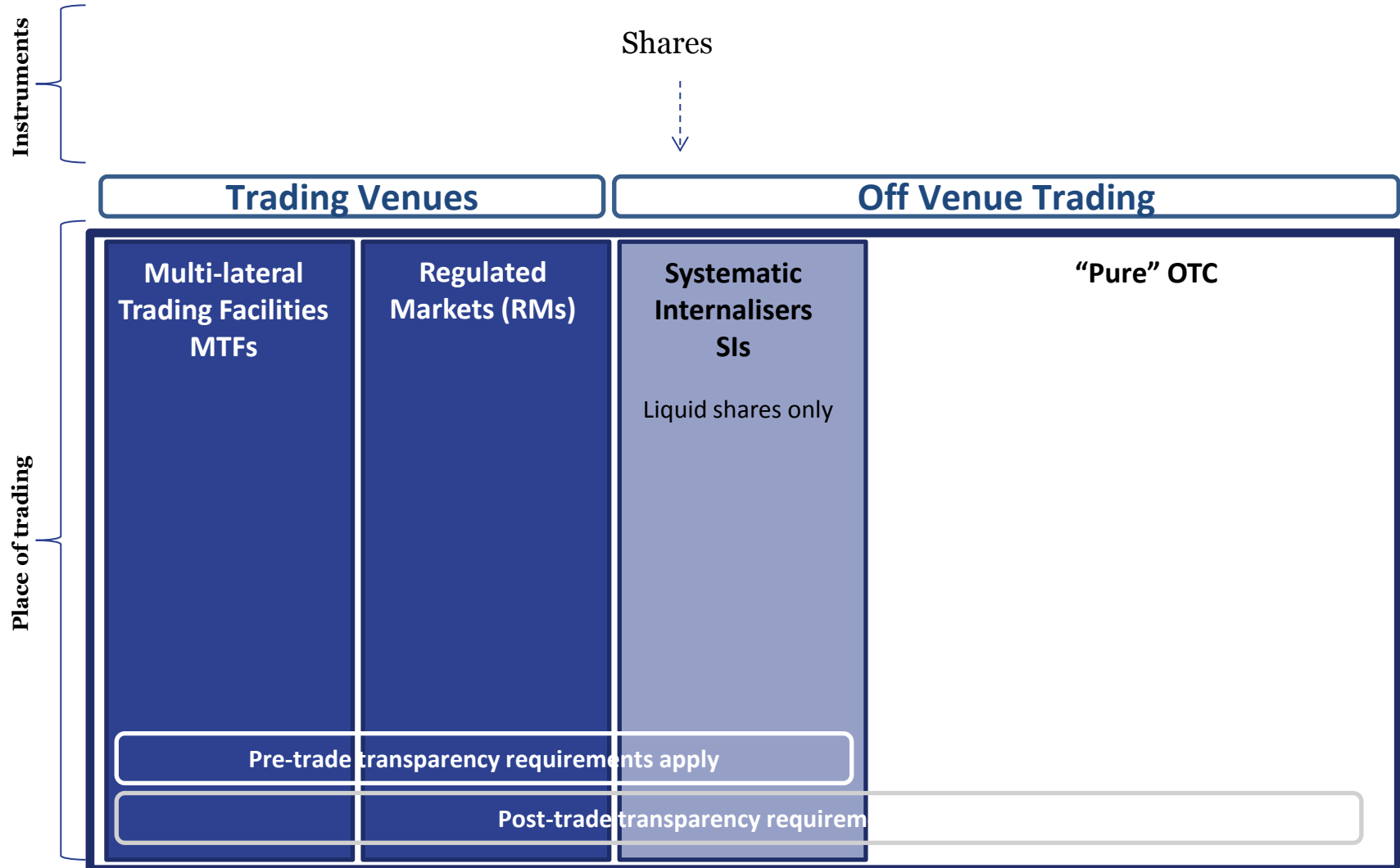
Regulated  
Markets (RMs)

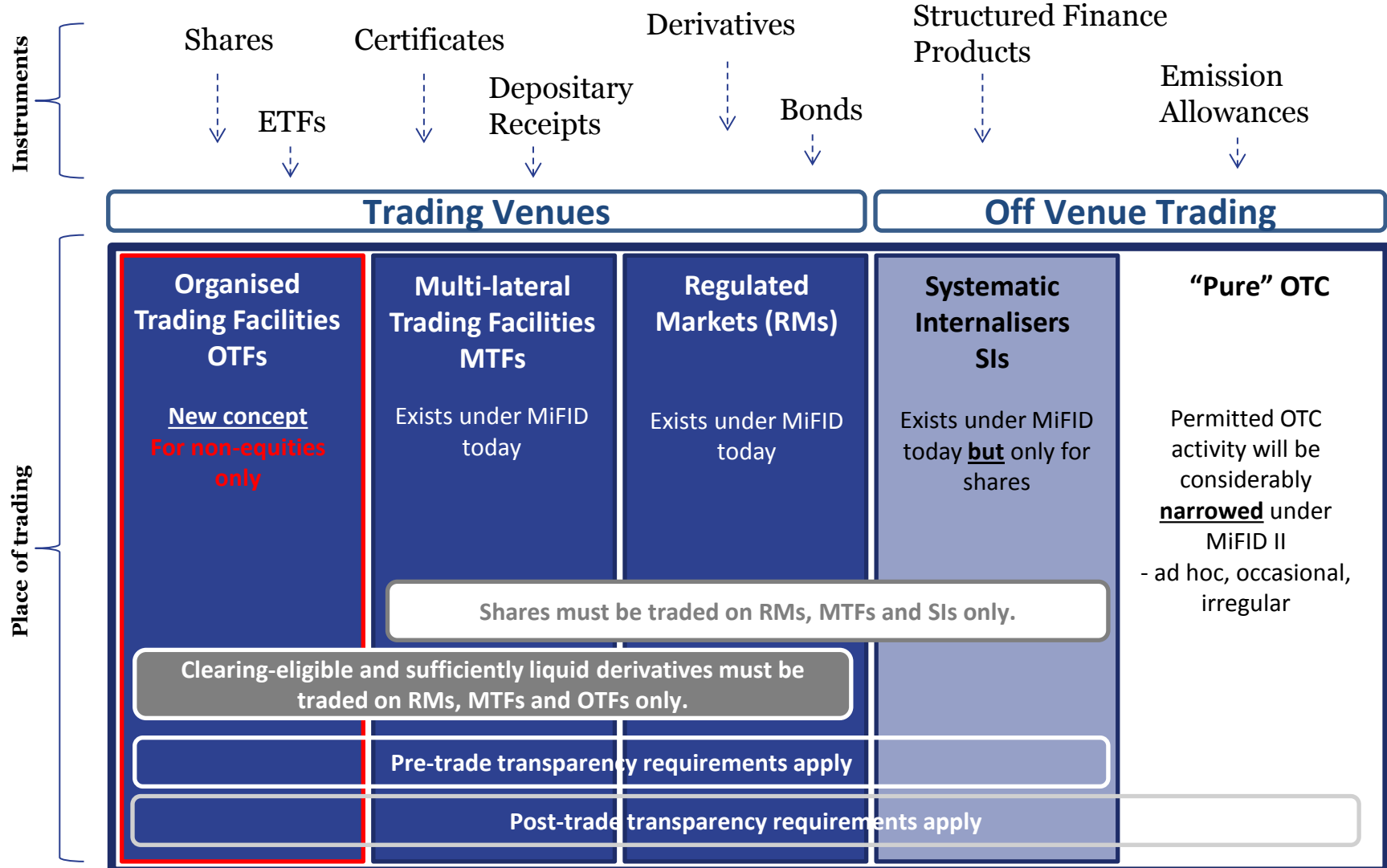
OTC

Pre-trade  
transparency

Post-trade  
transparency

Place of trading

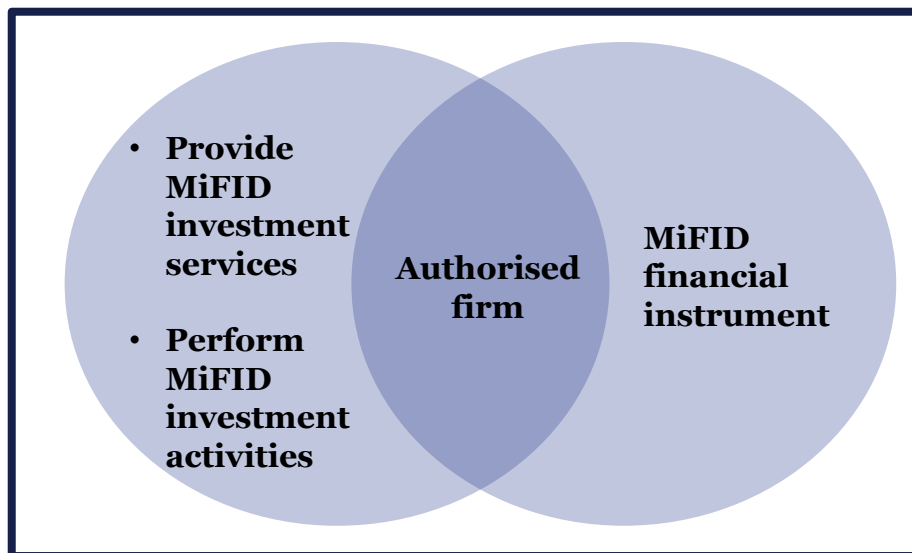




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## Investment services and activities (annex I, section A, MiFID II)

- (1) Reception and transmission of orders in relation to one or more financial instruments;
- (2) Execution of orders on behalf of clients;
- (3) Dealing on own account;
- (4) Portfolio management;
- (5) Investment advice;
- (6) Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis;
- (7) Placing of financial instruments without a firm commitment basis;
- (8) Operation of an MTF;
- (9) Operation of an OTF.

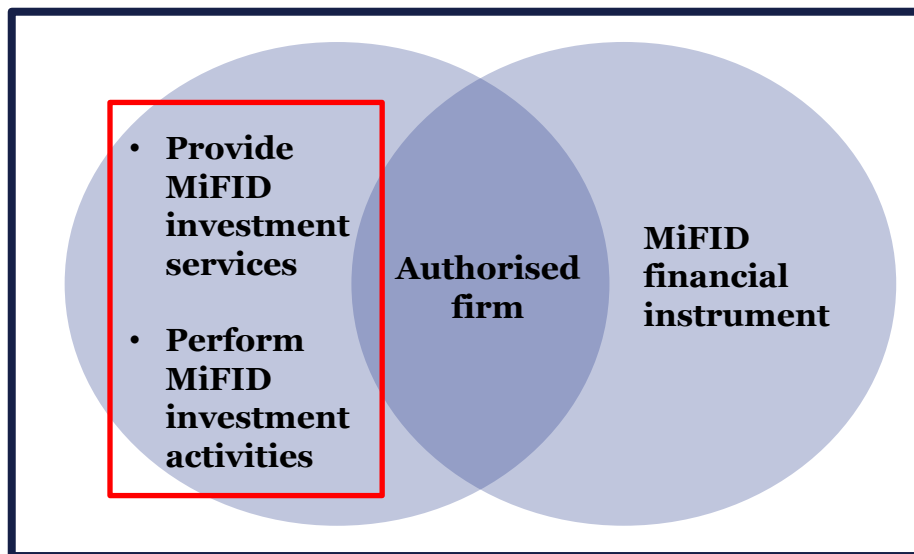


## Financial Instruments (annex I, section C, MiFID II)

- (1) Transferable securities
- (2) Money-market instruments
- ...
- (6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled;
- (7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in point 6 of this Section and not being for commercial purposes, which have the characteristics of other derivative financial instruments;
- ...
- (11) Emission allowances

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MiFID I		MiFID II	
<b>Article 2(1)(k)</b>	main business consists of dealing on own account in commodities and/or commodity derivatives	<b>Deleted</b>	
<b>Article 2(1)(i)</b>	dealing on own account in financial instruments, or providing investment services in commodity derivatives or derivative contracts providing the activity is ancillary to their main business	<b>Article 2(1)(j)</b>	dealing on own account in commodity derivatives/ emission allowances and derivatives thereof , or providing investment services in such instruments to customers/ suppliers providing the activity is ancillary to their main business
		<b>Article 2(1)(d)</b>	dealing on own account in instruments other than commodity derivatives/ emission allowances and derivatives thereof providing conditions met

## Ancillary activity – exemptions

	Exemption	ESMA DP
<b>1</b>	Intra-group liquidity exemption: <i>intra-group transactions referred to in Article 3 EMIR that serve group-wide liquidity or risk management purposes</i>	Proposes to follow EMIR definition
<b>2</b>	“Hedging exemption”: <i>transactions in derivatives which are objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity</i>	Proposes to follow EMIR definition
<b>3</b>	Liquidity obligation exemption: <i>transactions in commodity derivatives/ emission allowances entered into to fulfil obligations to provide liquidity on a trading venue where such obligations are required by regulatory authorities or trading venues</i>	Seeks examples

# Ancillary activity tests– test 1

## TEST 1

**Does a non-financial firm’s “ancillary activities” constitute a minority of activities at group level?**

### Calculations proposed in the DP

Capital employed for dealing on own account  
**plus**  
 Capital employed for the provision of other investment services to customers and suppliers of the main business  
**minus**  
 exempt activity

#### DIVIDED BY

Capital for overall activity at group level  
**minus**  
 Capital employed for dealing on own account  
**minus**  
 Capital employed for the provision of other investment services to customers and suppliers of the main business  
**minus**  
 exempt activity\*

Capital employed for dealing on own account  
**minus**  
 exempt activity

#### DIVIDED BY

Capital for overall activity at group level  
**minus**  
 Capital employed for dealing on own account  
**minus**  
 Capital employed for the provision of other investment services to customers and suppliers of the main business  
**minus**  
 exempt activity\*

Capital employed for the provision of other investment services to customers and suppliers of the main business  
**minus**  
 exempt activity

#### DIVIDED BY

Capital for overall activity at group level  
**minus**  
 Capital employed for dealing on own account  
**minus**  
 Capital employed for the provision of other investment services to customers and suppliers of the main business  
**minus**  
 exempt activity\*

## TEST 2

What is the size of the firm's trading activity per asset class compared to the overall size of trading activity?

### Calculations proposed in the DP

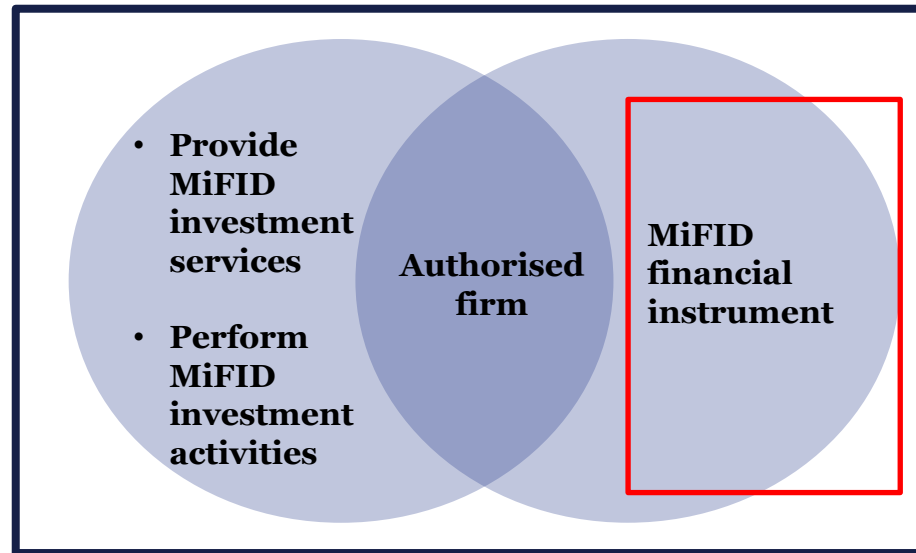
Volume of trading activity  
**minus**  
*exempt activity\**  
  
=  
  
*Size of firm's trading activity*

*Size of firm's trading activity*  
  
**DIVIDED BY**  
  
*Overall size of trading in the market*

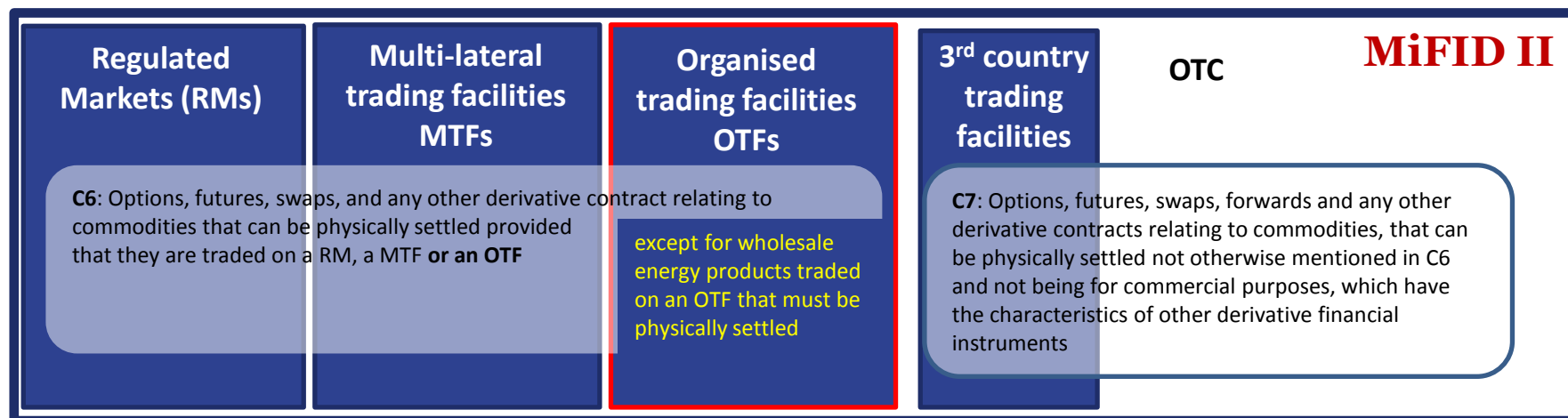
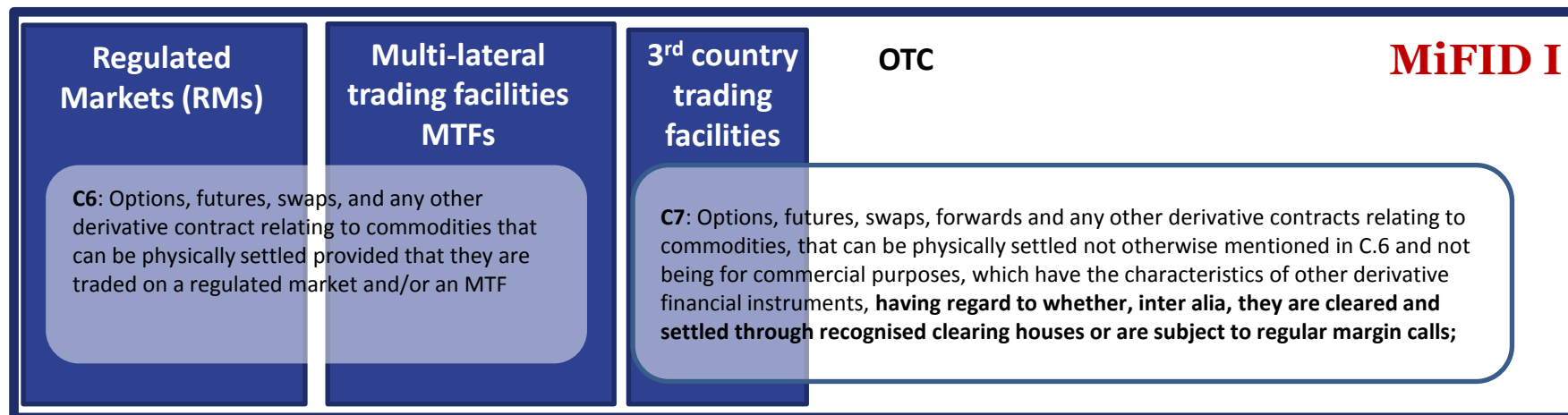
### Asset Classes

- (1) Metals
- (2) Oil & oil products
- (3) Coal
- (4) Emissions
- (5) Gas
- (6) Power
- (7) Agricultural products
- (8) Freight

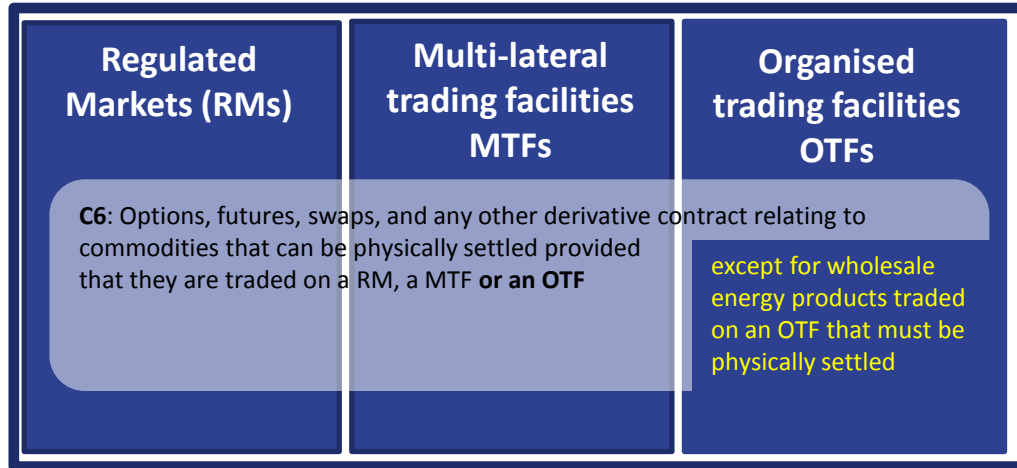
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# MiFID II scope: financial instruments – C6 and C7







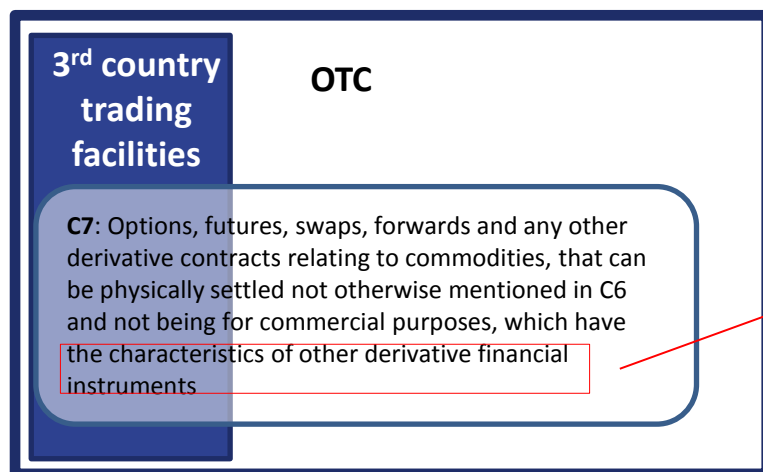
## 2 exemptions to C6:

- Permanent: “*wholesale energy products*” - derivatives with electricity and natural gas as underlying traded on an OTF and must be physically settled (under REMIT’s scope)
- Temporary & partial: “*C6 energy derivatives contracts*” - derivatives with coal or oil as underlying traded on an OTF and must be physically settled

## ESMA’s mandate:

- Further clarify notion of “*must be physically settled*”
- Specify derivative contracts of “*wholesale energy products*” and “*C6 energy derivatives contracts*”

## MiFID II scope: financial instruments – C7



Level 2 rules under MiFID I:  
Article 38, Regulation 1287/2006  
further develops notion of  
*“characteristics of other derivative financial instruments”*

### ESMA’s mandate:

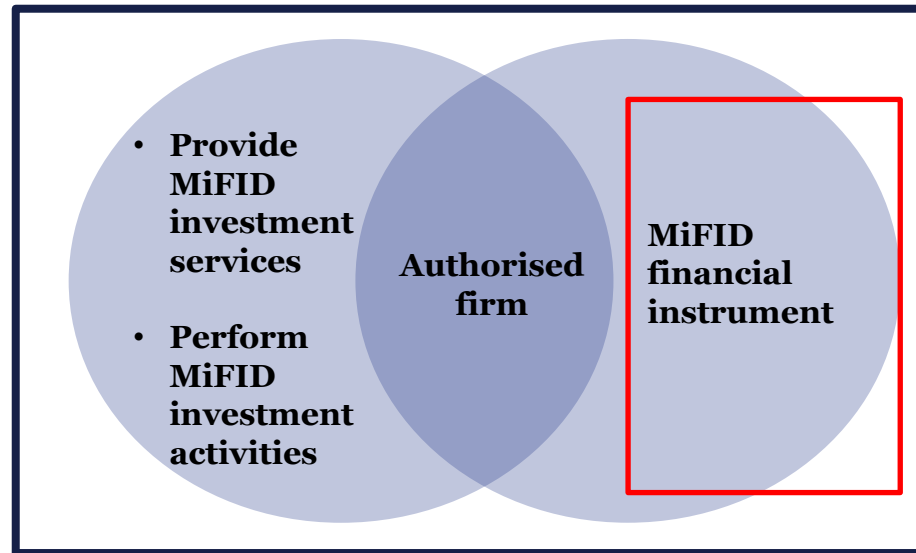
- Determining if any changes required to the existing level 2 rules

### ESMA’s proposals:

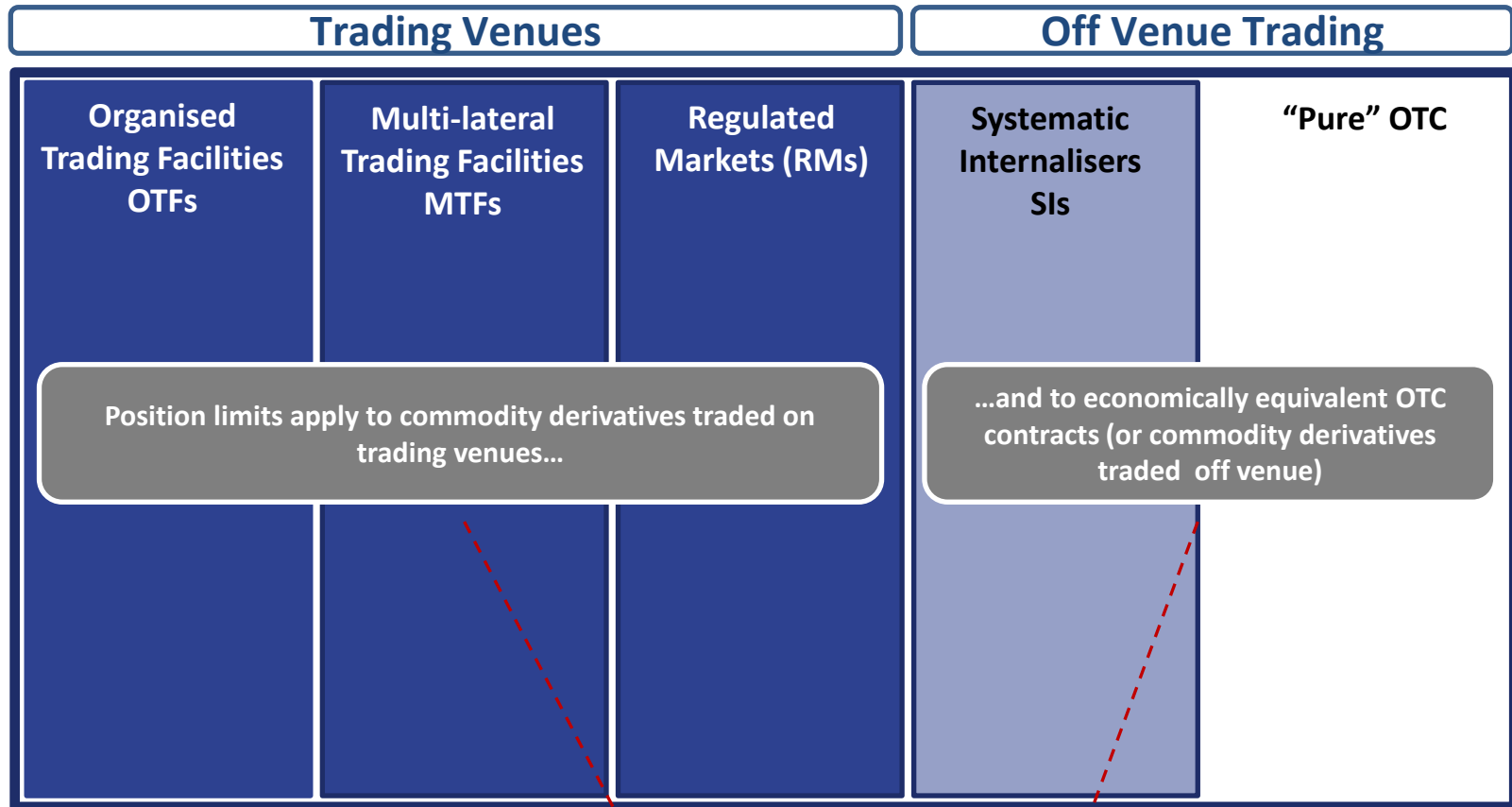
- Delete reference to clearing criterion
- Retain standardisation criterion as it is
- Change trading criterion (Article 38(1)(a)(iii)) from a contract is *“expressly stated to be equivalent to a contract traded on”* a trading venue to a contract *“equivalent to a contract...”*
- Other contracts which should be considered as being for *“commercial purposes”*

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## MiFID II scope – definition of financial instrument



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**Exemption to limits available for non-financial firms' hedging trades**

Type of contract	Type of limit	Limit based on...	Obtain data from...
<b>Physically settled</b>	<b>Spot</b>	Capacity constraints/ deliverable supply	Volume supplied by trading venue that lists the contract
	<b>All months</b>	Open interest	Volume supplied by trading venue that lists the contract
<b>Cash settled</b>	<b>Spot</b>	Open interest	Volume supplied by trading venue that lists the contract
	<b>All months</b>	Open interest	Volume supplied by trading venue that lists the contract

	Factor	Affect on limits
1	<b>Maturity</b>	Longer the maturity, the higher the limit
2	<b>Deliverable supply</b>	Larger the deliverable supply, the higher the limit
3	<b>Open interest</b>	Larger the open interest, the higher the limit
4	<b>Volatility</b>	More volatile the market the lower the limit
5	<b>Number and size of market participants</b>	The more participants the lower the limit
6	<b>Characteristics of underlying market</b>	The more inflexible the market the lower the limit
7	<b>New contracts</b>	Higher limit in “nurturing” stages



Baseline = x%  
of deliverable  
supply

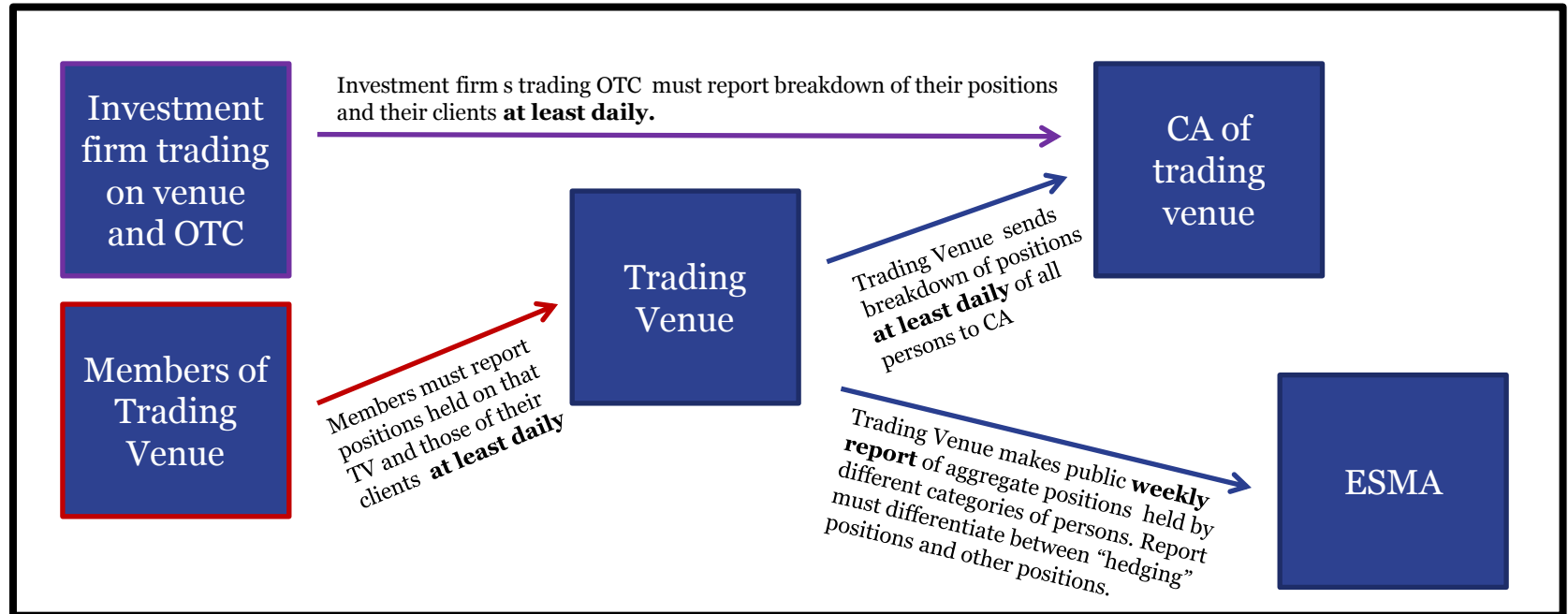
NCA can vary  
baseline by x%  
+/-



Metals Oil Coal Gas Power Agricultural products Freight Climatic variables Inflation rates & economic stats



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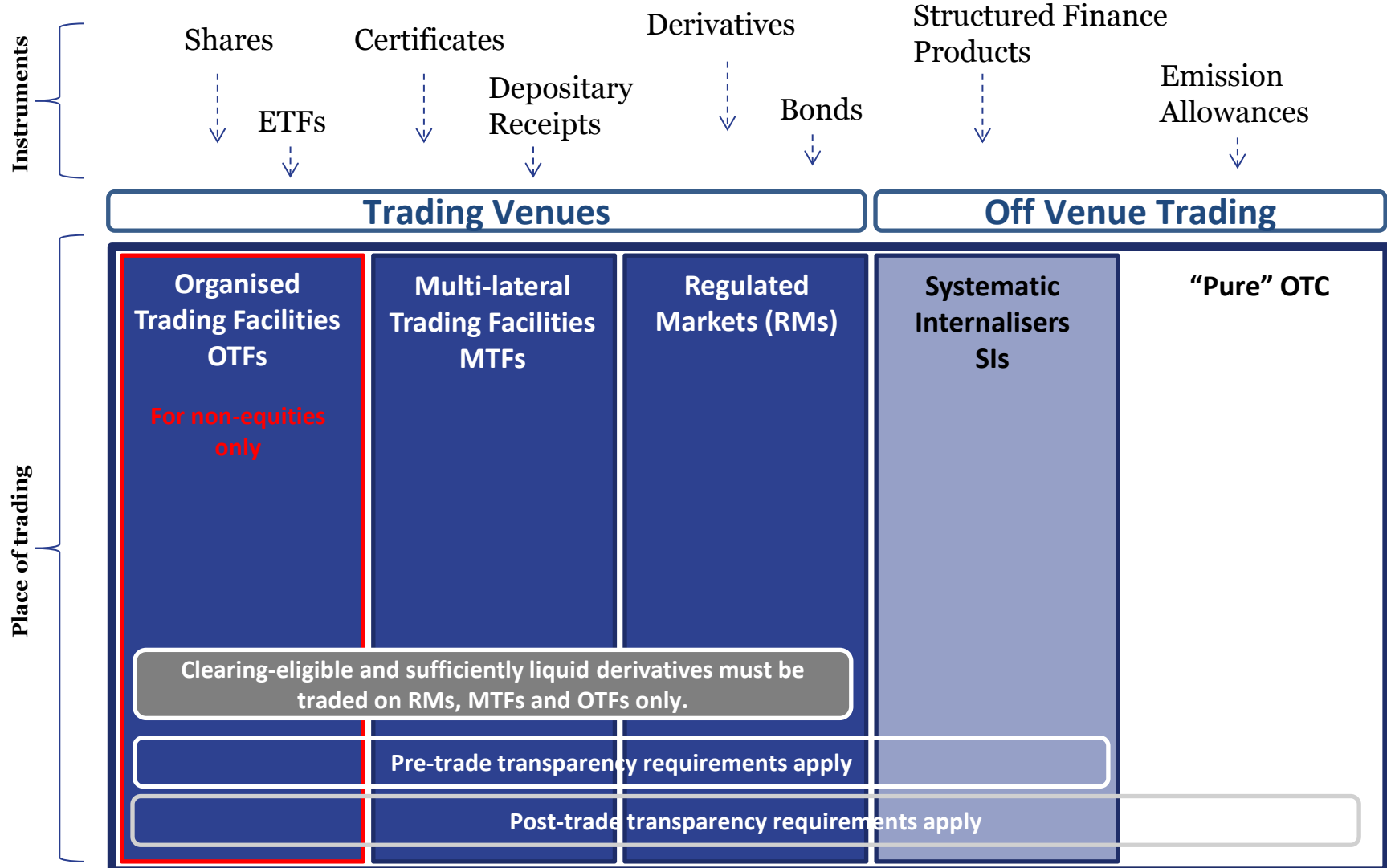


{Name of trading venue}						{Date of the report}					
{Commodity derivative contract}											
Current week's report		Investment firms		Investment funds		Other financial institutions		Commercial undertakings		Emissions operators	
	Total	Long	Short	Long	Short	Long	Short	Long	Short	Long	Short
	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}
Changes from last week's report (+/-)	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}
Percentage of open interest	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}
Number of position holders in each category	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}	{value}

## Proposals in the ESMA Consultation Paper

- **Threshold 1: total number of persons that hold a position in the contract**
  - More than 30 position holders in a given contract on a given trading venue
  - Where there are 4 or fewer position holders in a category, the number of position holders in that category will not be reported
- **Threshold 2: total size of open positions**
  - Exceeds a level of four times the deliverable supply

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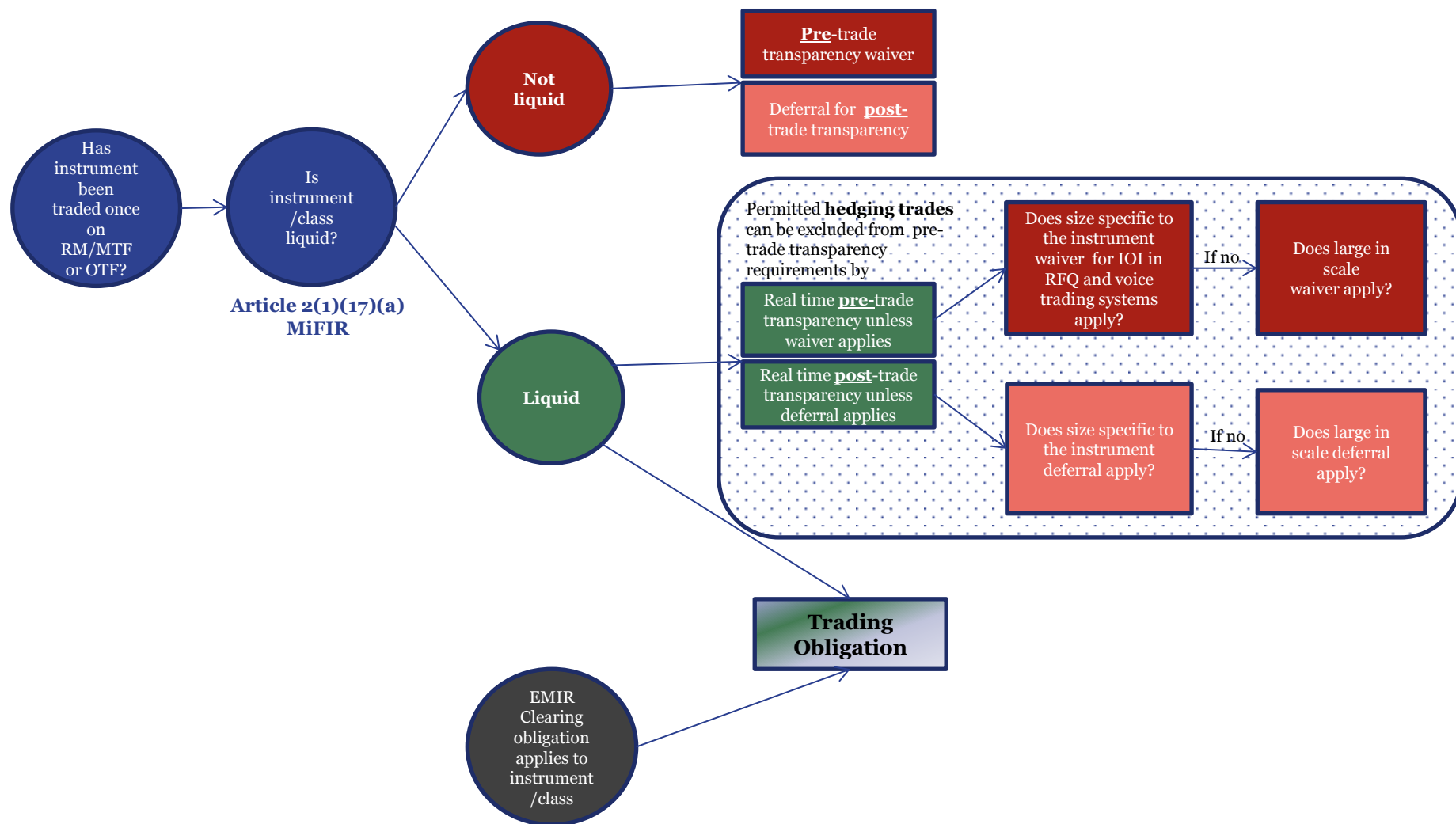
	Component	ESMA's proposal in DP
<b>1</b>	<b>Average frequency of transactions</b>	Minimum number transactions and minimum number of active trading days.
<b>2</b>	<b>Average size of transactions</b>	Total turnover of period divided by number of trading days
<b>3</b>	<b>Market participants (no./size, ratio to traded financial instrument)</b>	Any member or participant of a trading venue being involved in at least one transaction in a given market
<b>4</b>	<b>Average size of spreads (where available)</b>	Use end-of-day relative bid/ask spreads as published by most relevant market in terms of liquidity

# Proposed segmentation for commodity derivatives

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Financial instrument	Product types	Sub-product types		Other potential liquidity sub-categories	Proposed metrics
Commodity Derivatives	Metals (ME)	Precious (PR)	Gold	Transaction type (Spot fwd / Swap / Option / Loan lease / Exotic / Transmission)  Underlying  Deliverable currency  Settlement type (physical vs cash)	Notional amount of traded contracts (i.e. number of contracts * contract value)  Note: Number of contracts could be “1”
			Silver		
		Non Precious (NP)	Platinum		
			Palladium		
			Aluminium Alloy		
			Aluminium		
			Copper		
			Lead		
			Nickel		
			Tin		
			Zinc		
			North American Special Aluminum Alloy Contract (NASAAC)		
			Steel		
			Cobalt		
			Molybdenum		
	Energy (EN)	Oil (OI)			
		Natural gas (NG)			
		Coal (CO)			
		Electricity (EL)			
		Inter-energy (IE)			
	Index (IN)				
	Agricultural (AG)	Grains oilseeds (GO)			
		Dairy (DA)			
		Livestock (LI)			
		Forestry (FO)			
		Softs (SO)			

# Transparency requirements for non-equity instruments







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