

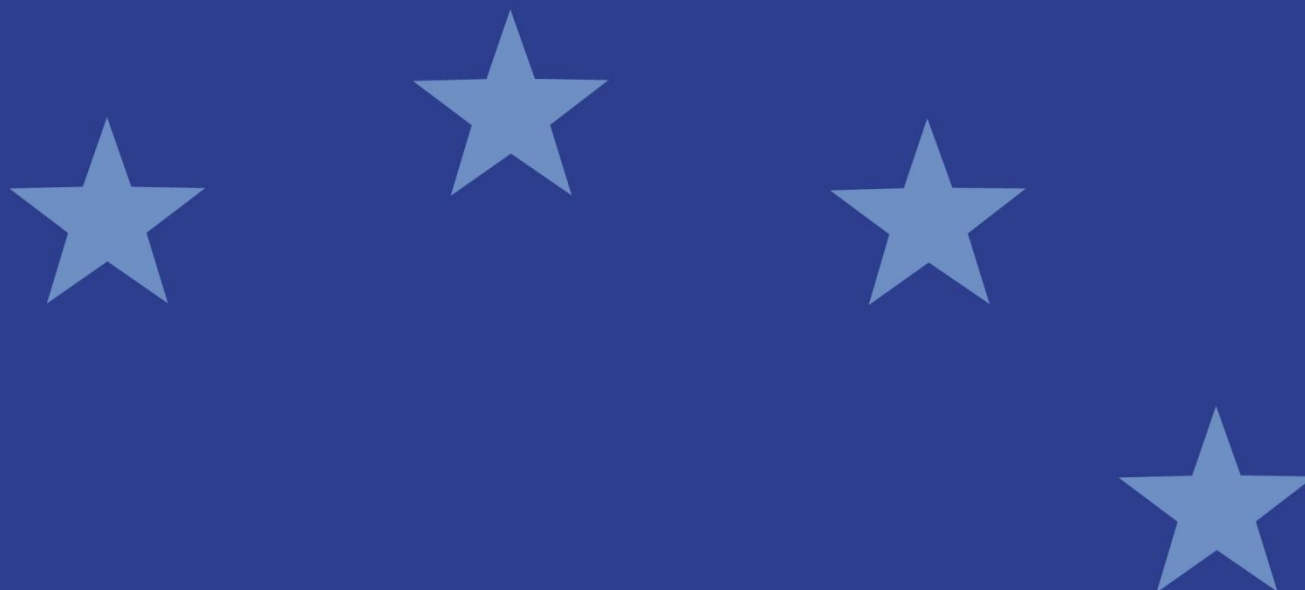


European Securities and
Markets Authority

28 January 2015 | DG Agri Expert Group, Brussels,

MiFID II: ESMA

Catherine Sutcliffe



1. Big Picture Overview

2. Scope of MiFID II

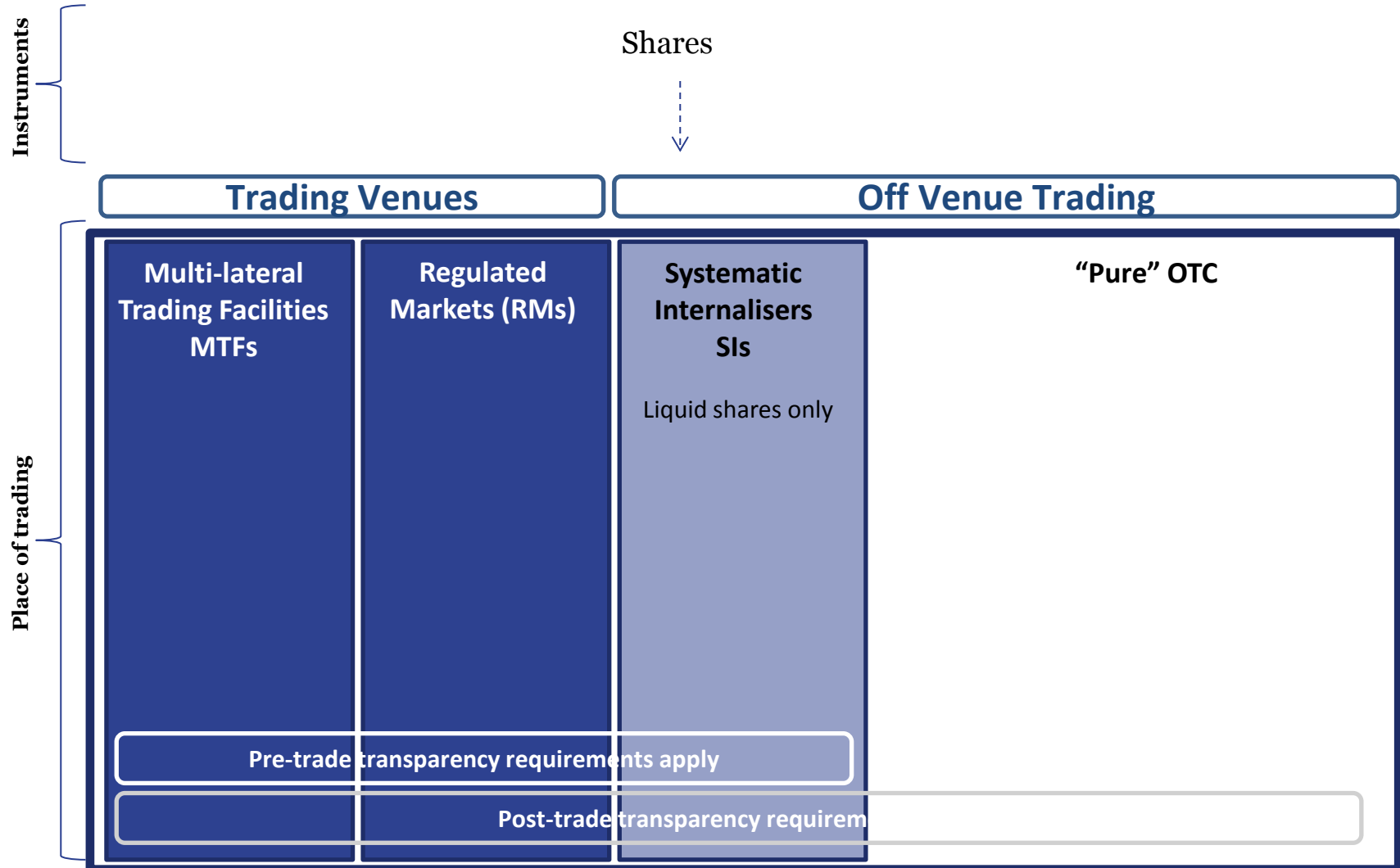
- Ancillary activity
- Definition of financial instruments

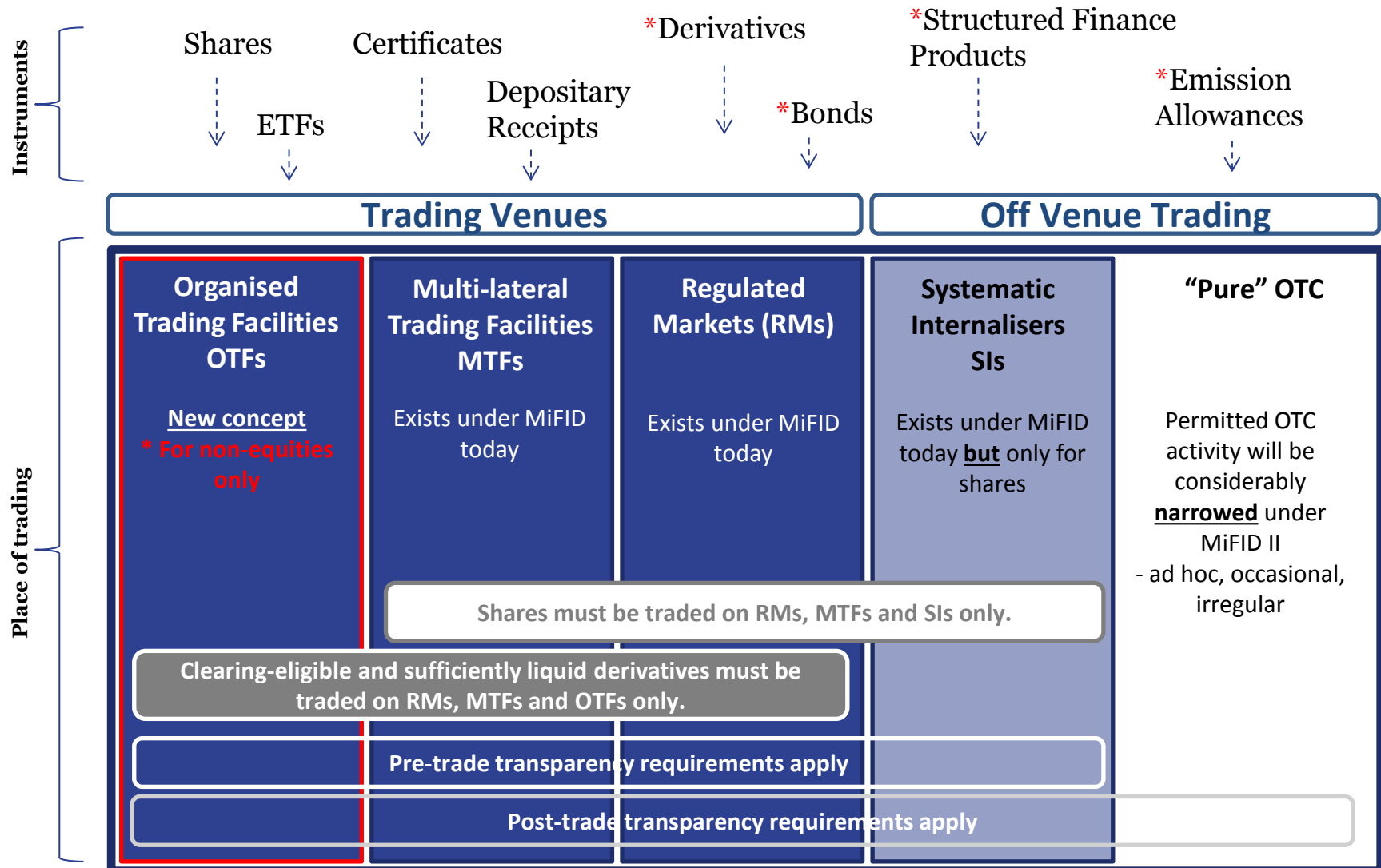
3. Position control framework

- Position limits
- Position reporting

4. Liquidity

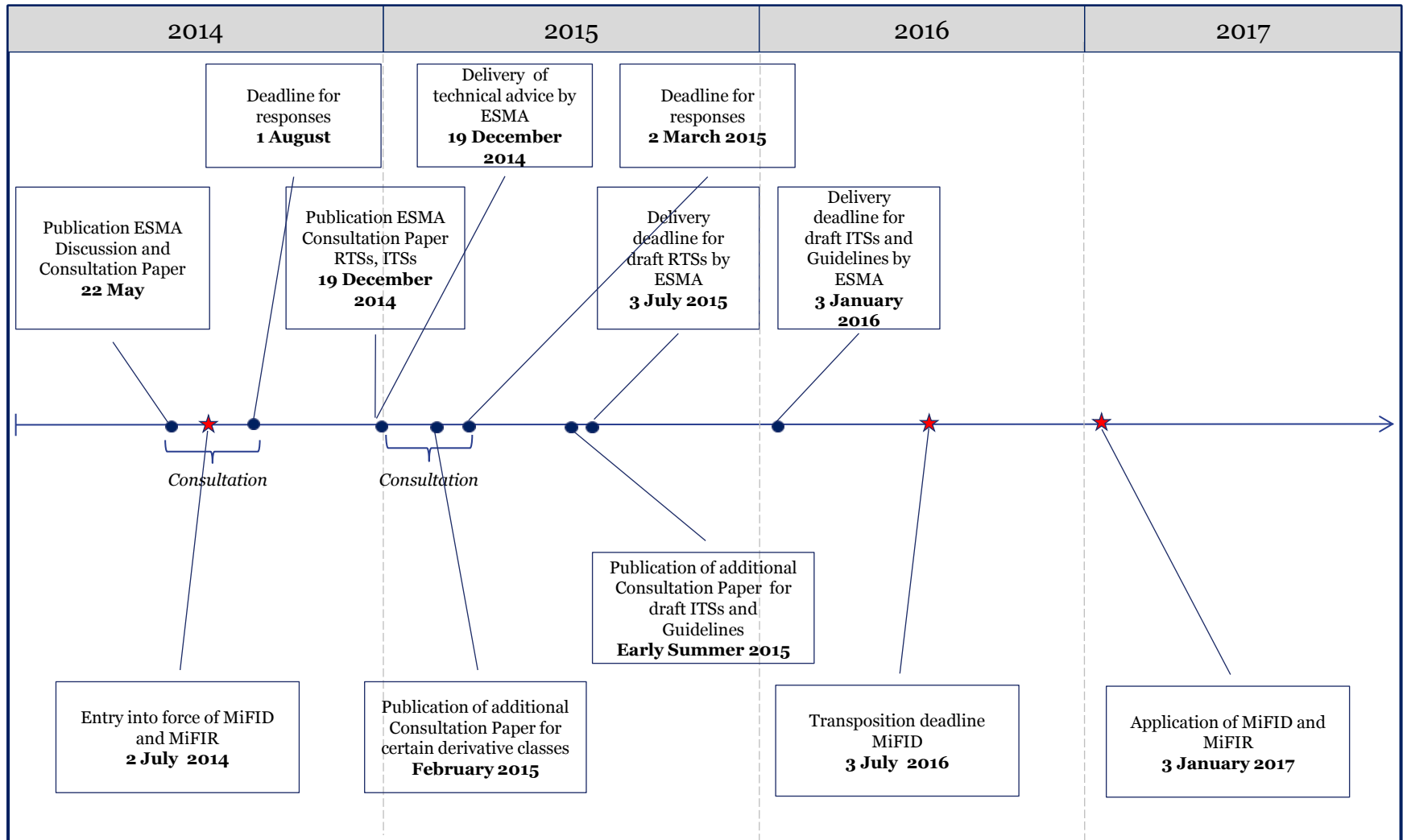
5. Transparency

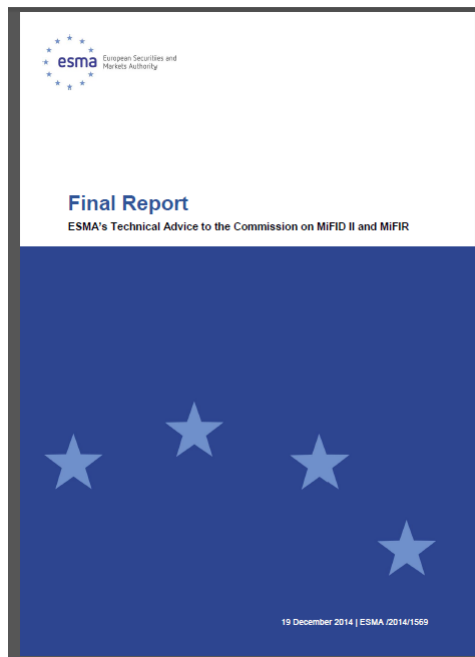




ESMA's Timetable for Delivery

21 January 2015 | London

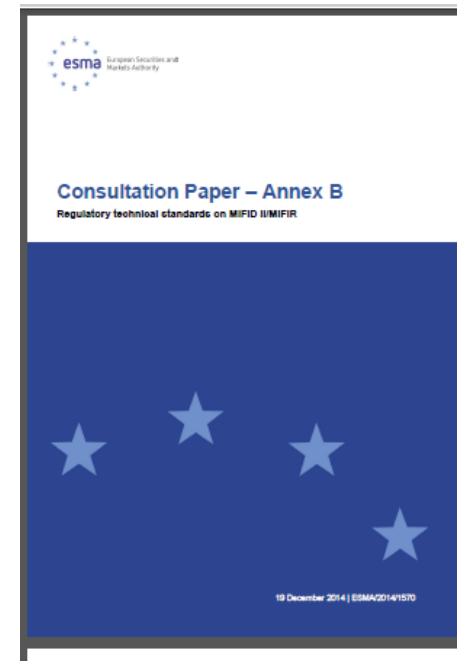




Delivery of technical advice by ESMA to European Commission on 19 December 2014



Publication of ESMA Consultation Paper (CP) on RTSs, ITSs on 19 December 2014. Deadline for comments is 2 March 2015



Annex B to CP – draft legal text of RTSs and ITSs

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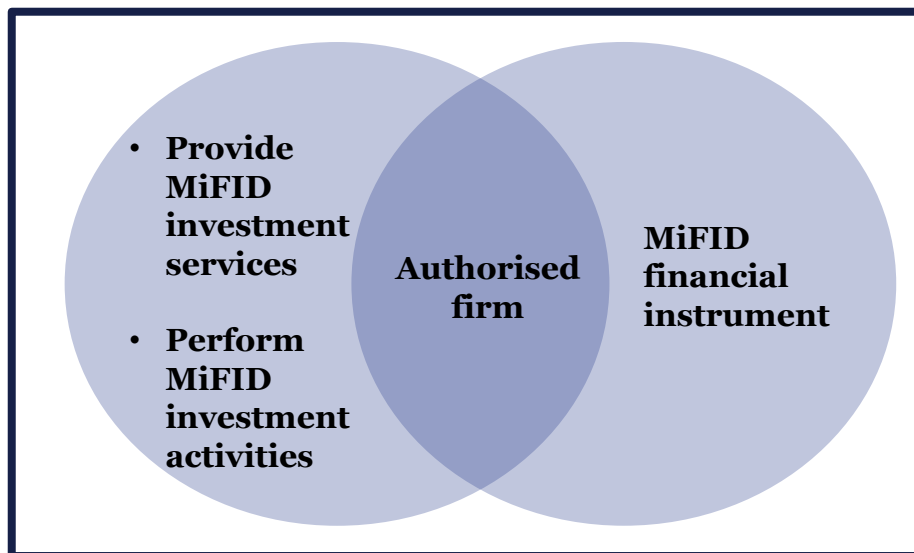
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Investment services and activities (annex I, section A, MiFID II)

- (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)

...

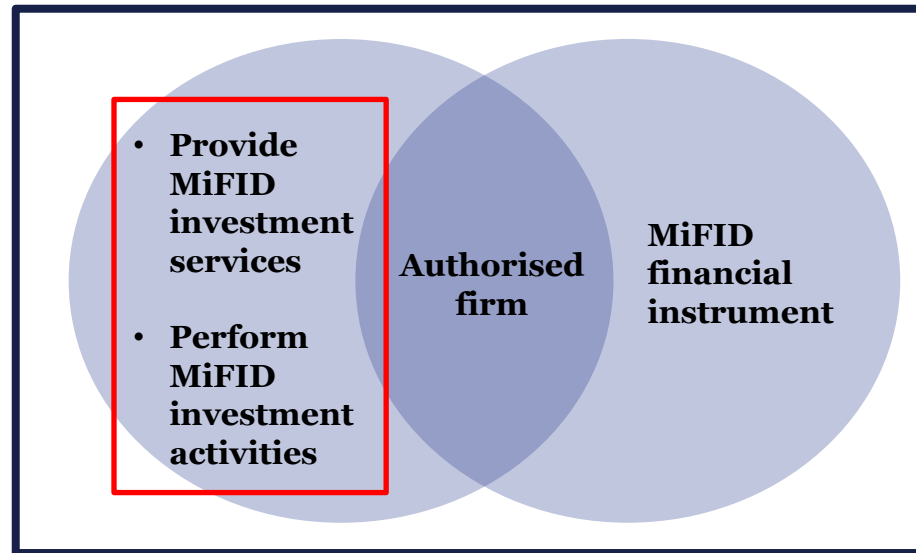
(6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market, a MTF, or an OTF, except for wholesale energy products traded on an OTF that must be physically settled;

(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	
Article 2(1)(k)	main business consists of dealing on own account in commodities and/or commodity derivatives	Deleted	
Article 2(1)(i)	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	Article 2(1)(j)	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
		Article 2(1)(d)	dealing on own account in instruments other than commodity derivatives/ emission allowances and derivatives thereof providing conditions met

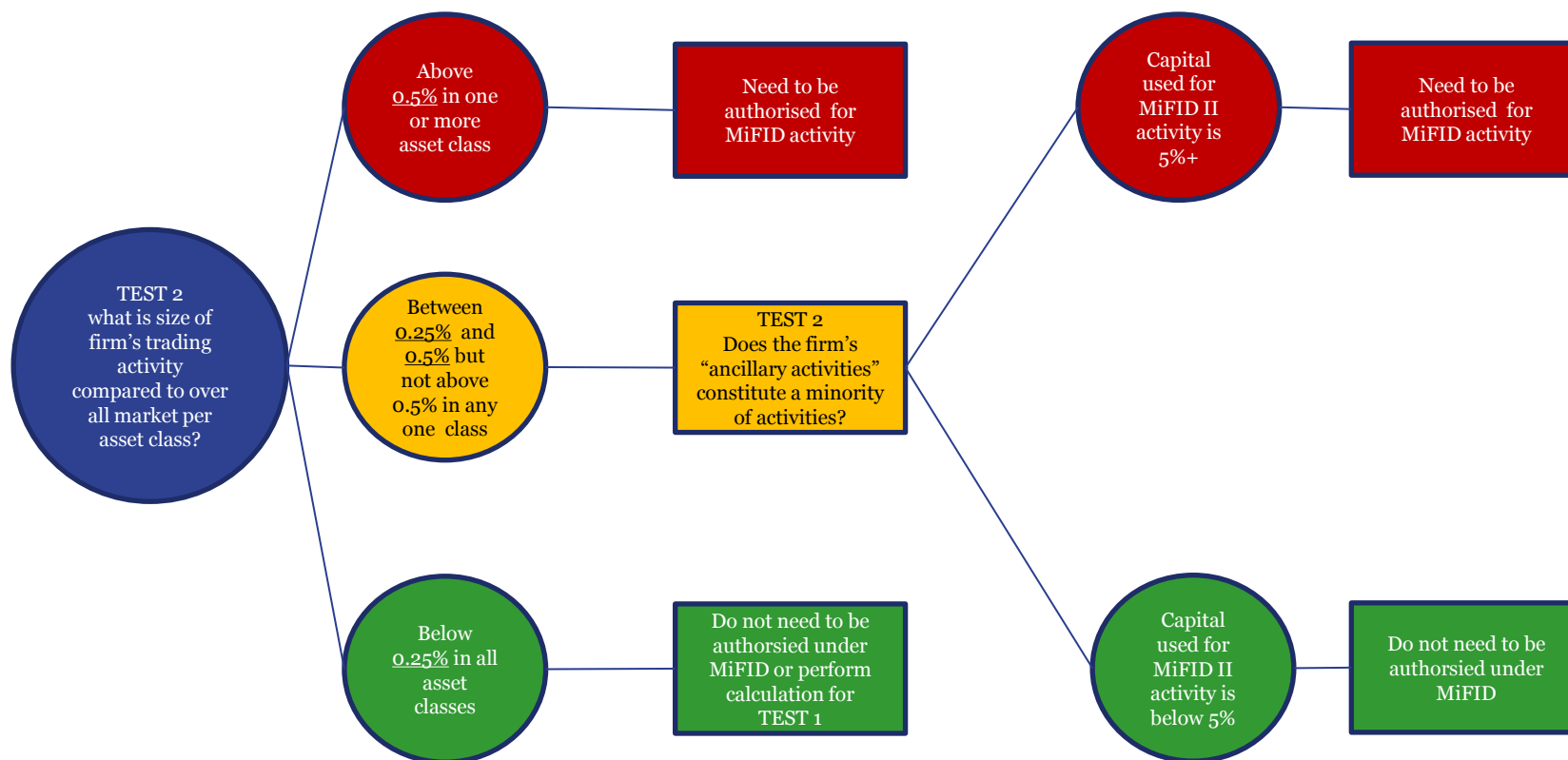
Ancillary activity – “Privileged transactions”

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	Exemption	ESMA CP
1	Intra-group liquidity exemption: <i>intra-group transactions referred to in Article 3 EMIR that serve group-wide liquidity and/or risk management purposes</i>	Proposes to follow EMIR definition
2	“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
3	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>	

Overview of proposed ancillary activity methodology

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TEST 2

Is the size of the non-financial firm's trading activity – per asset class – below 0.5% at group level?

Calculation for size of trading activity

Size of trading activity at group level in the relevant asset class in the EU (*numerator)

divided by

Size of overall trading activity at in the relevant asset class in the EU (denominator)

equals

% of firm's trading in an asset class compared with the size of the overall market trading activity in the EU in that asset class

*Calculation for determining the size of the firm's trading activity in a commodity asset class at group level in the EU (numerator)

Volume of the overall trading activity in the relevant asset class of the person seeking the exemption at group level in the EU

minus

Volume of privileged exemptions

minus

Volume of trading in licensed activity (i.e. trading activity undertaken by a MiFID authorised firm in the group)

equals

Size of firm's trading activity in an asset class at group level in the EU

Asset Classes

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

TEST 1

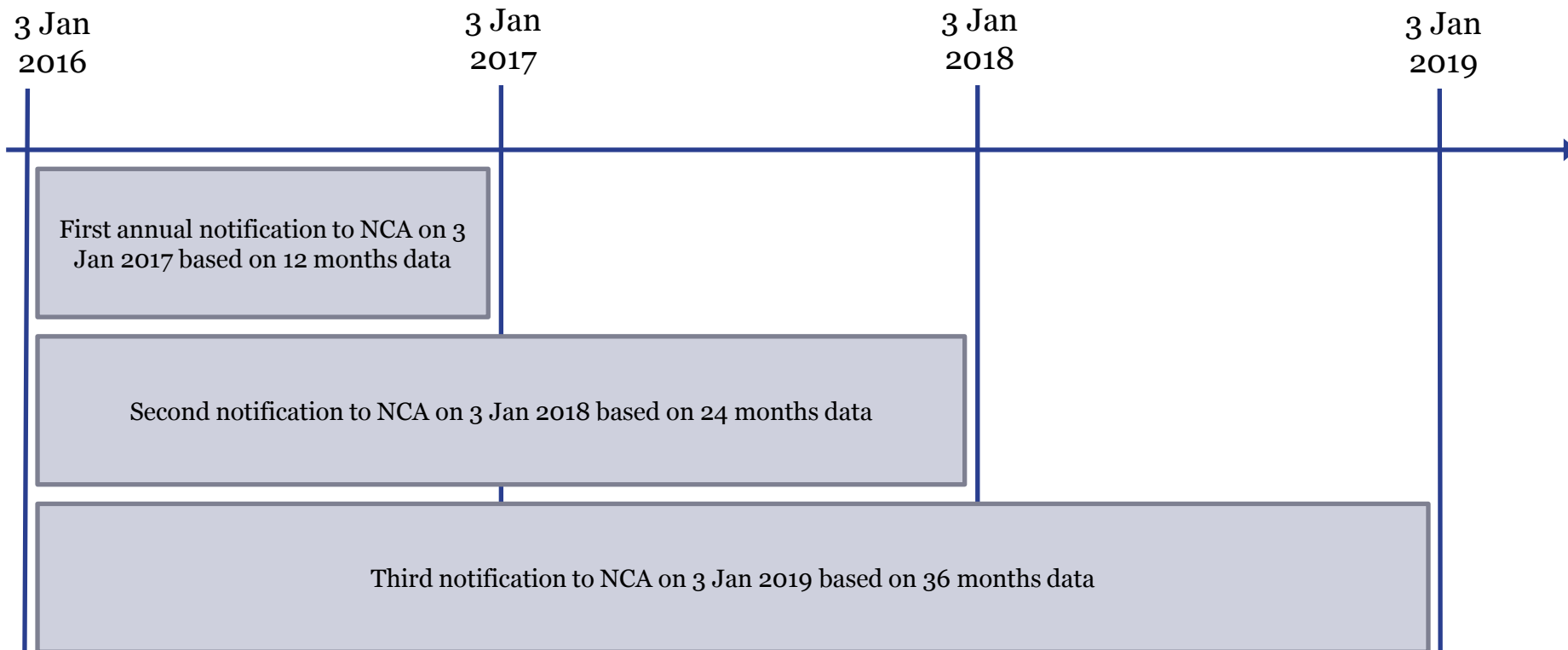
Does a non-financial firm's "ancillary activities" constitute a minority of activities – i.e. below 5% - at group level?

Calculation for determining % capital employed for ancillary activity

$$\frac{\begin{array}{l} \text{Capital employed for MiFID II activity at group level (*numerator)} \\ \text{divided by} \\ \text{Capital employed for business globally at group level (denominator)} \end{array}}{\text{equals}} \\ \text{\% of capital used by a group for MiFID II activity}$$

***Calculation for capital employed for MiFID II activity at group level in the EU (numerator)**

$$\begin{array}{l} \text{Capital employed by the person seeking the exemption for } \underline{\text{dealing on own account}} \text{ in commodity derivatives, EUAs and derivatives thereof} \\ \text{in the EU at group level} \\ \text{plus} \\ \text{Capital employed by the person seeking the exemption for } \underline{\text{providing other investment services}} \text{ in commodity derivatives, EUAs and} \\ \text{derivatives thereof in the EU at group level} \\ \text{minus} \\ \text{Sum of capital employed for privileged exemptions} \\ \text{minus} \\ \text{Capital employed for licensed activity (i.e. trading activity undertaken by a MiFID authorised firm in the group)} \end{array} \\ \text{equals} \\ \text{capital employed for MiFID II activity at group level in the EU}$$



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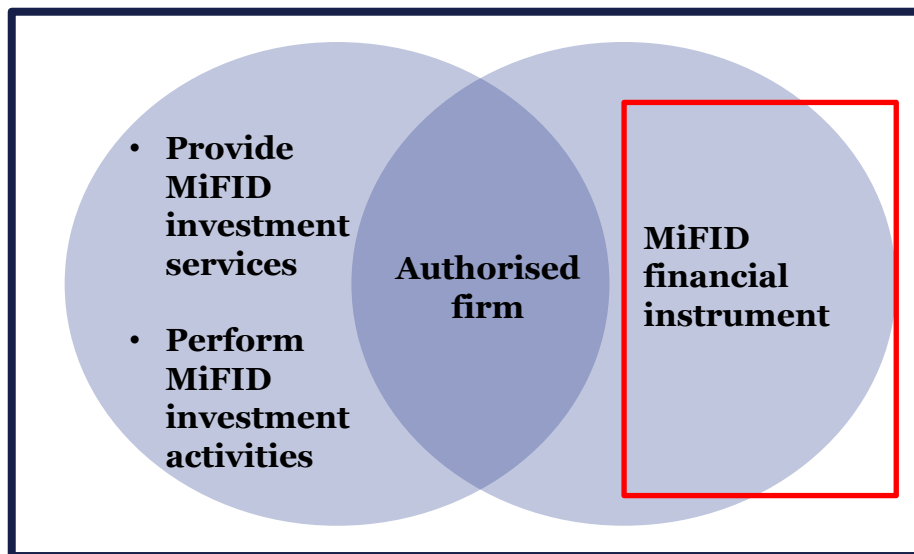
3. Position control framework

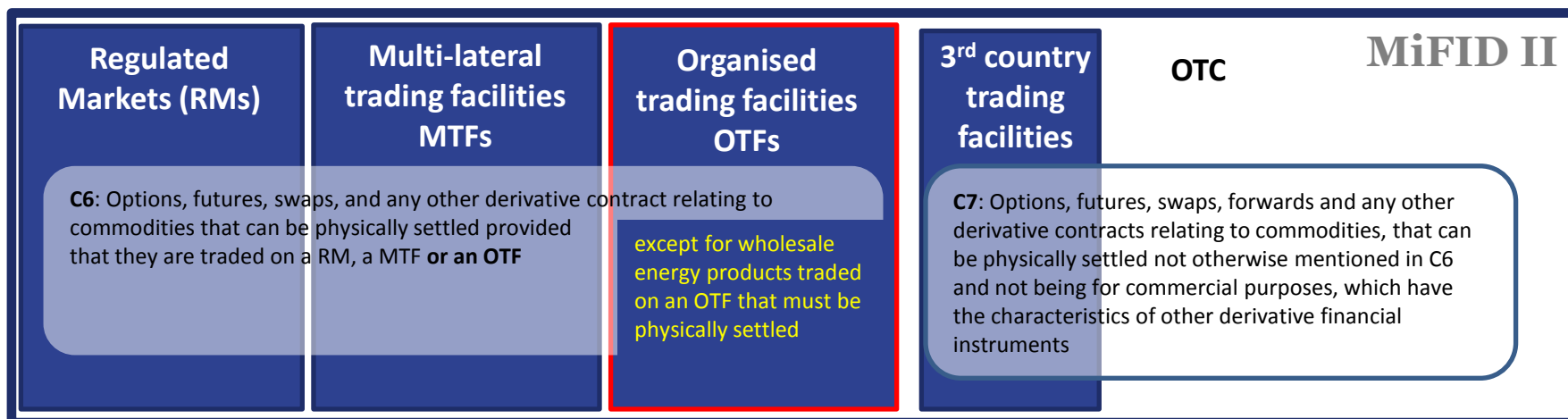
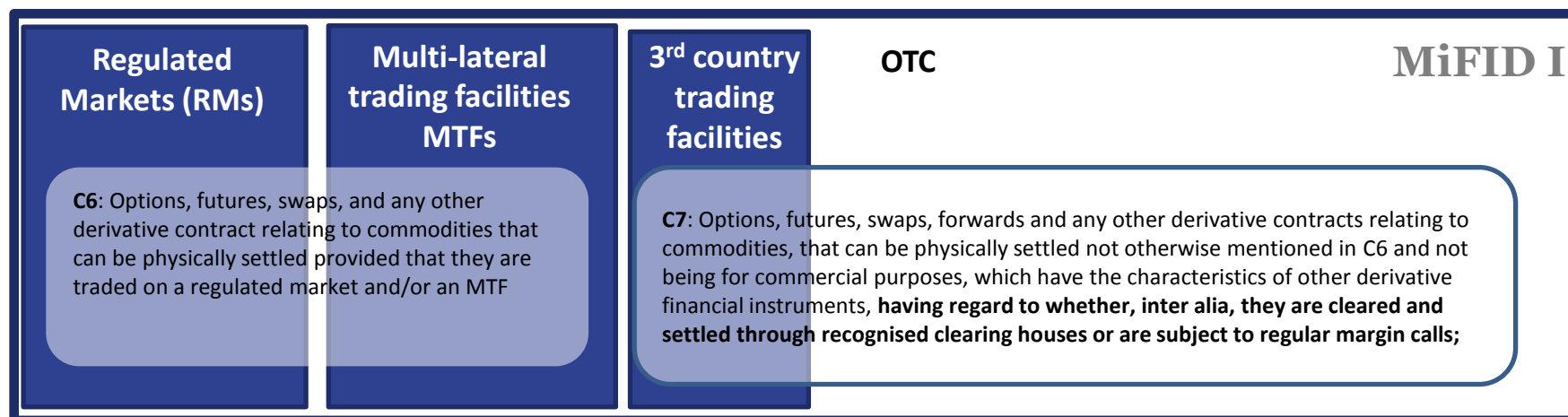
- Position limits
- Position reporting

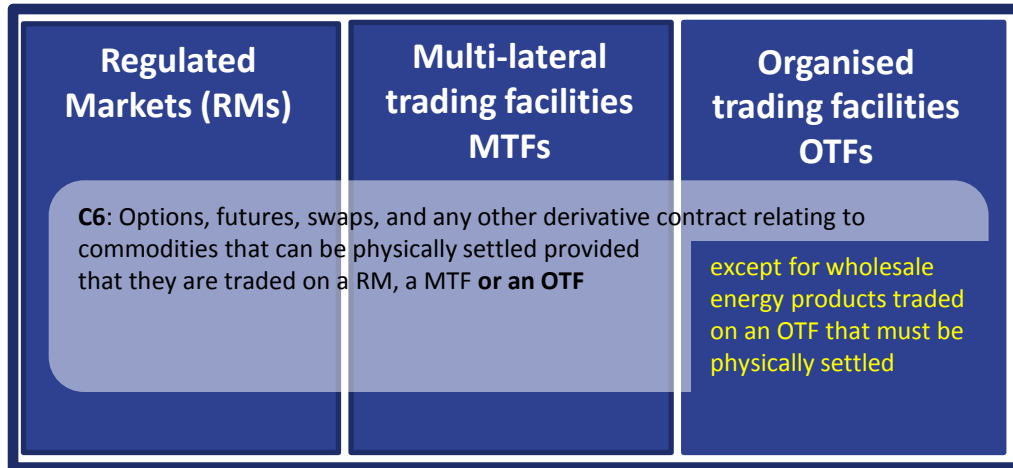
4. Liquidity

5. Transparency

MiFID II scope – definition of financial instruments





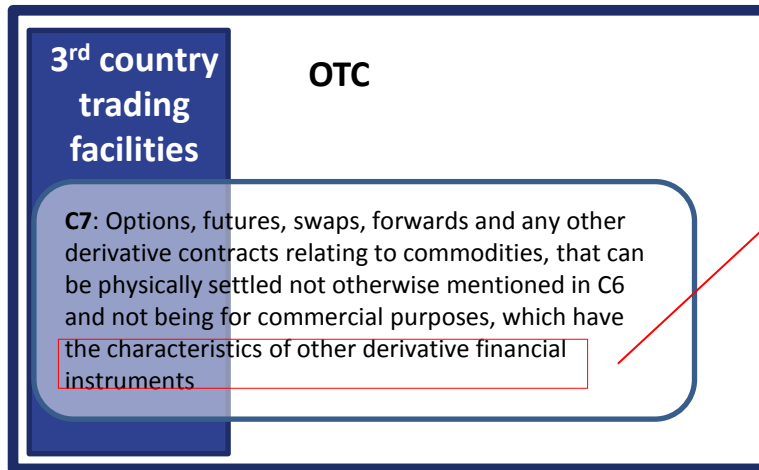


Two exemptions to C6:

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



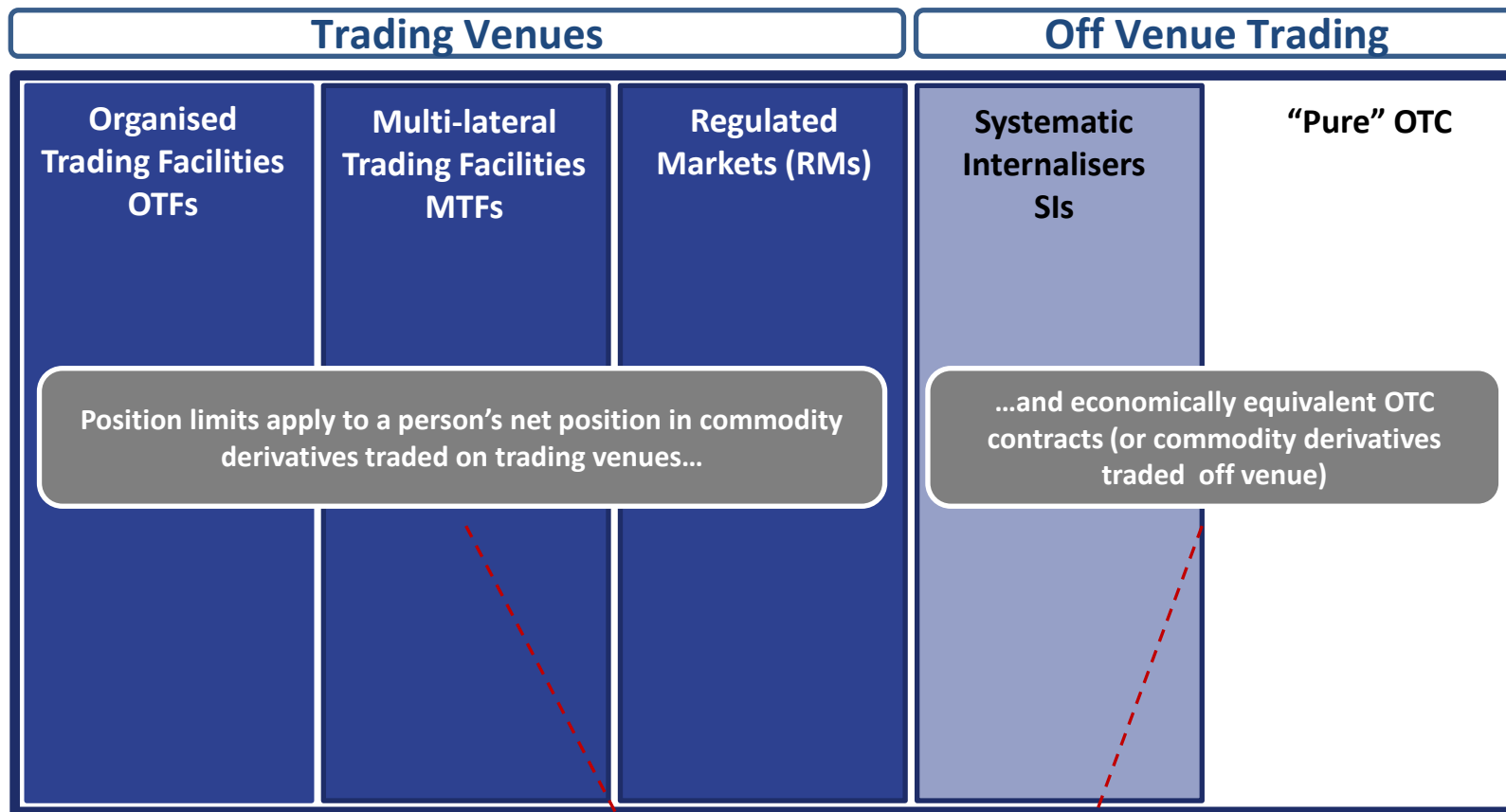
Level 2 rules under MiFID I:
Article 38, Regulation 1287/2006
further develops notion of
“characteristics of other derivative financial instruments”

ESMA’s mandate: determine if
any changes required to the existing
level 2 rules under MiFID I

ESMA’s advice to EC:

- Retain definitions of ‘spot contract’ and ‘commercial purpose’ as is
- Delete reference to clearing criterion
- Retain standardisation criterion as is
- Change trading criterion (Article 38(1)(a)(iii)) from a contract taht is *“expressly stated to be equivalent to a contract traded on”* a trading venue, to a contract *“equivalent to a contract...”*

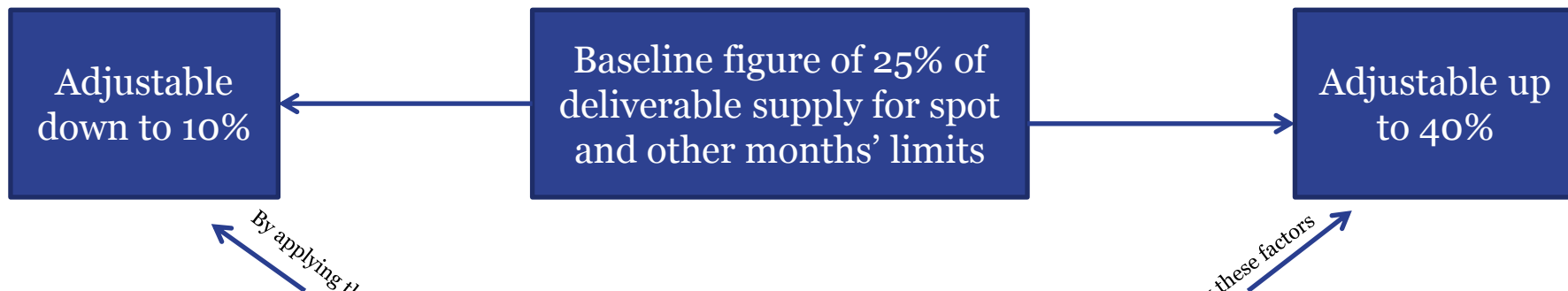
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Exemption to limits available for non-financial firms' 'hedging trades' – NFC must apply to NCA to use exemption

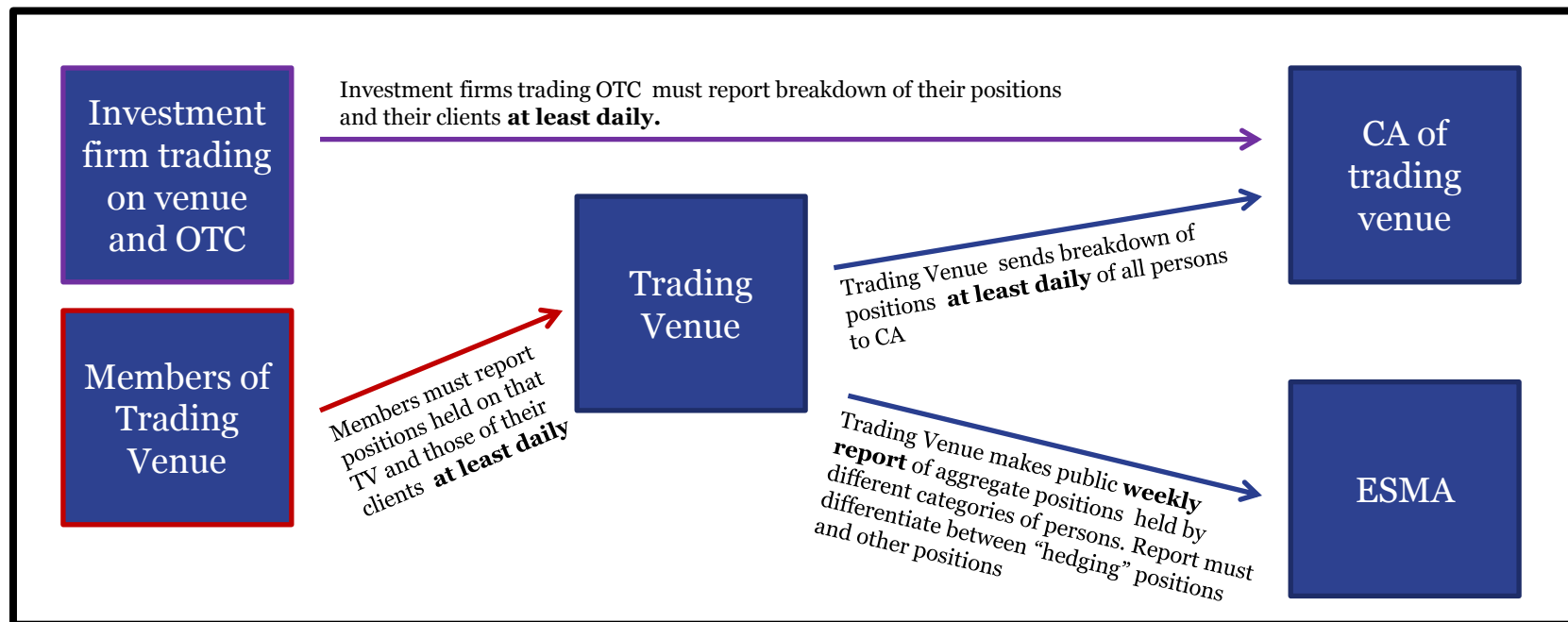
Consultation Paper: 7.2 and 7.3; pages 529 - 551
Annex B: RTS 29 (page 381) and RTS 30 (page 390)

Type of contract	Type of limit	Limit based on...	Obtain data from...
Physically settled	Spot	<i>Deliverable supply</i> of commodity used either as settlement for, or pricing reference to, the commodity derivative contract	<i>Trading Venue</i> that lists the relevant contract
	Other months		
Cash settled	Spot		
	Other months		



	Factor	Affect on limits
1	Maturity	Longer the maturity, the higher the limit Greater the frequency of expiry, the higher the limit
2	Deliverable supply	Larger the deliverable supply, the higher the limit Accuracy of determining deliverable supply
3	Open interest	Larger the open interest, the higher the limit
4	Volatility	Limits should not increase volatility
5	Number and size of market participants	The more participants the lower the limit (restrictions on supply/ method of transportation and delivery/ structure of market)
6	Characteristics of underlying market	The more inflexible the market the lower the limit
7	New contracts	Higher limit in “nurturing” stages

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	Field	Explanatory comments
1.	Date of the business day of the reported positions	The report shall be produced as at the close of the business day and submitted by 09.00 am local time on the next business day
2.	Reporting investment firm ID	Legal Entity Identifier (“LEI”)
3.	End client ID	LEI for legal entities or other identifiers for natural persons, as specified by ESMA in Regulation (EU) No xxxx/xxxx [TS under Article 26 MiFIR]. Note: if the position is held as a proprietary position of the reporting firm, this field will be identical to field 2 above
4.	Unique product identifier of on-venue contract	Alternative Instrument Identifier should be used. See field 5 below for treatment of OTC contracts that are economically equivalent to contracts that are traded on trading venues
5.	Trading venue identifier	Either the Market Identifier Code (“MIC”) or for off-exchange positions in economically equivalent OTC contracts, the code “XOFF”
6.	Position maturity	Either “SPOT” for spot month or “ALL” for all other months. Note: separate reports are required for spot months and all other months in order to facilitate the monitoring of compliance with Article 57(1).
7.	Position quantity	Position expressed in the number of contracts
8.	Indicator of whether position is long or short	Indicated by the use of “+” (long) or “-” (short)
9.	Indicator of whether the position is risk reducing in relation to commercial activity	Indicated by the use of “yes” (position is risk reducing) or “no” (position is not risk reducing).

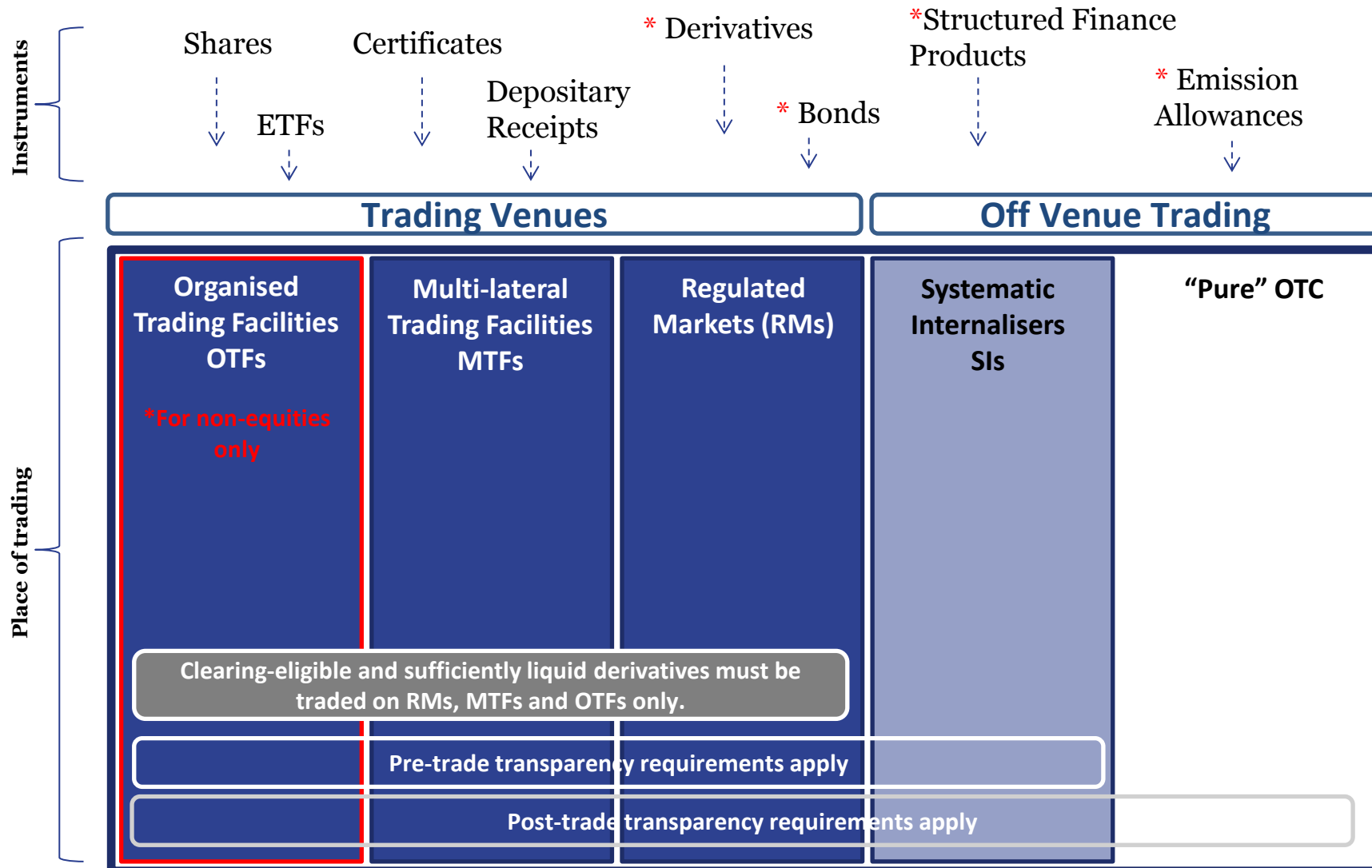
Table of fields to be reported in daily position reports

Trading Venues must produce a weekly report per commodity derivative traded on their venue when both the following thresholds are met:

- **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
 - *NB: 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

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

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	Component	ESMA's proposal
1	Average frequency of transactions	Minimum number of transactions and minimum number of active trading days.
2	Average size of transactions	Total turnover/notional amount traded divided by number of trading days
3	Market participants (no./size, ratio to traded financial instrument)	Any member or participant of a trading venue being involved in at least one transaction in a given market
4	Average size of spreads (where available)	

Dataset from 7 trading venues, 1 June 2013 - 31 May 2014: 13,088 instruments

Futures	% of trades			% notional amount traded		
	1-3 months	3-6 months	> 6 months	1-3 months	3-6 months	> 6 months
cocoa	32	41	27	32	39	29
coffee	44	45	11	43	46	11
corn	35	41	24	43	38	19
Wheat (milling & feed)	31	35	34	33	37	30
potato	23	28	49	23	28	49
rapeseed	28	47	25	34	44	22
sugar	30	47	23	32	47	21

Findings for futures:

- Approximately 75% liquidity concentrated in short maturities (less than 6 months)

FUTURES: statistics across different maturity classes

Options	% of trades			% notional amount traded		
	1-3 months	3-6 months	> 6 months	1-3 months	3-6 months	> 6 months
cocoa	27	35	38	22	33	45
coffee	38	51	11	28	60	12
corn	12	34	54	14	38	48
Wheat (milling & feed)	14	33	53	13	36	51
rapeseed	21	30	49	18	44	38

Findings for options:

- Mixed results

OPTIONS: statistics across different maturity classes

Liquidity parameters: agricultural commodity derivative is liquid if following two thresholds met:

- an average of 10 trades per day or more; and
- an average notional amount per day of EUR 500,000 or more

Findings and proposals in CP:

- 21 sub-classes identified: 13 futures and 8 options
- 13 sub-classes designated as liquid
 - average no. trades per day is 1,903
 - average notional amount traded is EUR 118 million
- 8 sub-classes designated as illiquid
 - average no. trades per day is 3
 - average notional amount traded is EUR 180,000

Agricultural commodity derivatives analysis (cont'd)

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Underlying	Liquidity Test: 10 trades per day, €500,000 notional amount per day	Num of instruments	Num of trades per day	Notional Amount per day
Cocoa	Liquid	16	7,278	456,017,794
Coffee	Liquid	16	6,102	224,953,753
Corn	Liquid	16	433	17,361,104
Potato	Liquid	6	67	888,608
Rapeseed	Liquid	14	2,452	142,853,818
Sugar	Liquid	14	4,454	142,173,351
Wheat (feed)	Liquid	16	92.53	10,391,327
Wheat (milling)	Liquid	16	3,709	280,734,458
Dairy	Illiquid	46	2.58	202,371
Livestock	Illiquid	31	2.26	47,474
Malting barley	Illiquid	16	1.40	3,403
Olive oil	Illiquid	9	5.75	480,270
Salmon	Illiquid	89	7.81	352,656

FUTURES: liquid and illiquid classes

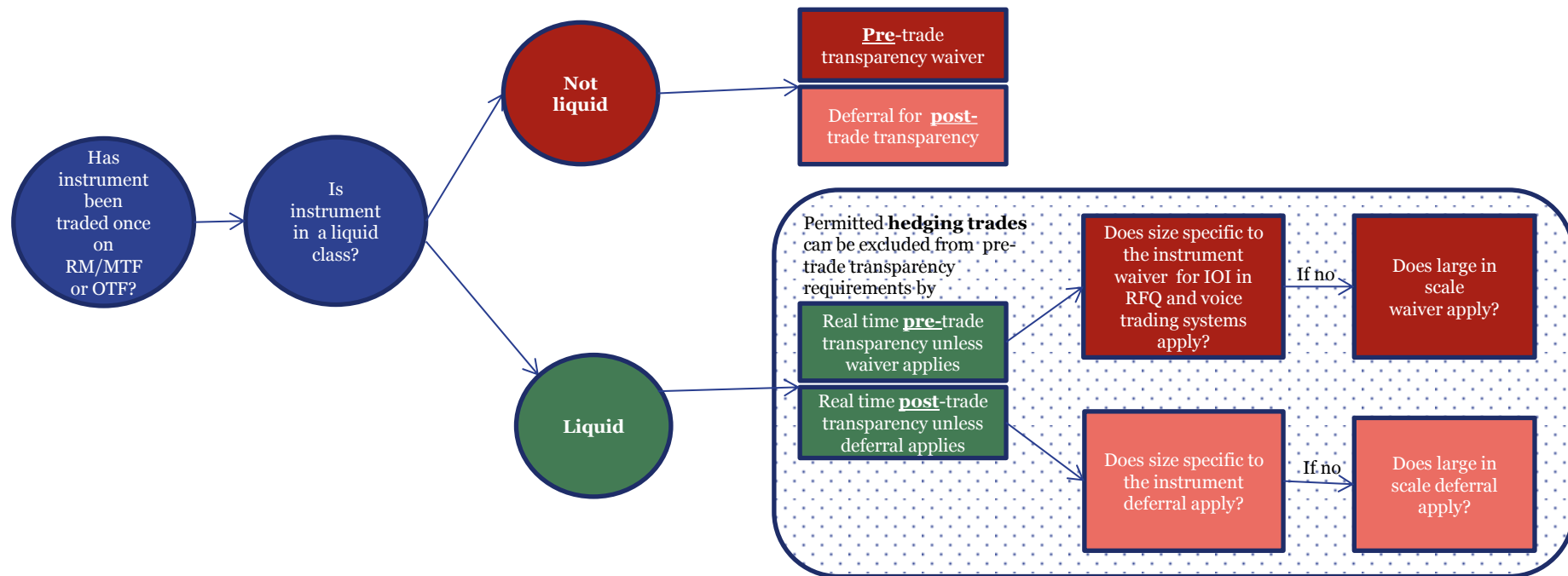
Underlying	Liquidity Test: 10 trades per day, €500,000 notional amount per day	Num of instruments	Num of trades per day	Notional Amount per day
Cocoa	Liquid	1,690	19	122,201,411
Coffee	Liquid	1,464	36	52,182,230
Corn	Liquid	3,238	6	2,378,855
Rapeseed	Liquid	2,626	22	20,521,884
Wheat (milling)	Liquid	1,644	66	64,139,156
Wheat (feed)	Illiquid	1,412	0.38	140,581
Salmon	Illiquid	179	0.09	17,666
Sugar	Illiquid	530	0.14	200,634

OPTIONS: liquid and illiquid classes

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Transparency requirements for non-equity instruments

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RTS9, Annex III - Table 41: Agricultural commodity futures – liquid classes

AGRICULTURAL COMMODITY FUTURES - LIQUID CLASSES		
UNDERLYING	LIS (€)	SSTI (€)
Cocoa	1,000,000	500,000
Coffee	1,000,000	500,000
Corn	1,000,000	500,000
Potatoe	1,000,000	500,000
Rapeseed	1,000,000	500,000
Sugar	1,000,000	500,000
Wheat (feed)	1,000,000	500,000
Wheat (milling)	1,000,000	500,000

RTS9, Annex III - Table 42: Agricultural commodity futures – illiquid classes

AGRICULTURAL COMMODITY FUTURES - CLASSES NOT HAVING A LIQUID MARKET		
OTHERS	LIS (€)	SSTI (€)
	1,000,000	500,000

RTS9, Annex III - Table 43: Agricultural commodity options – liquid classes

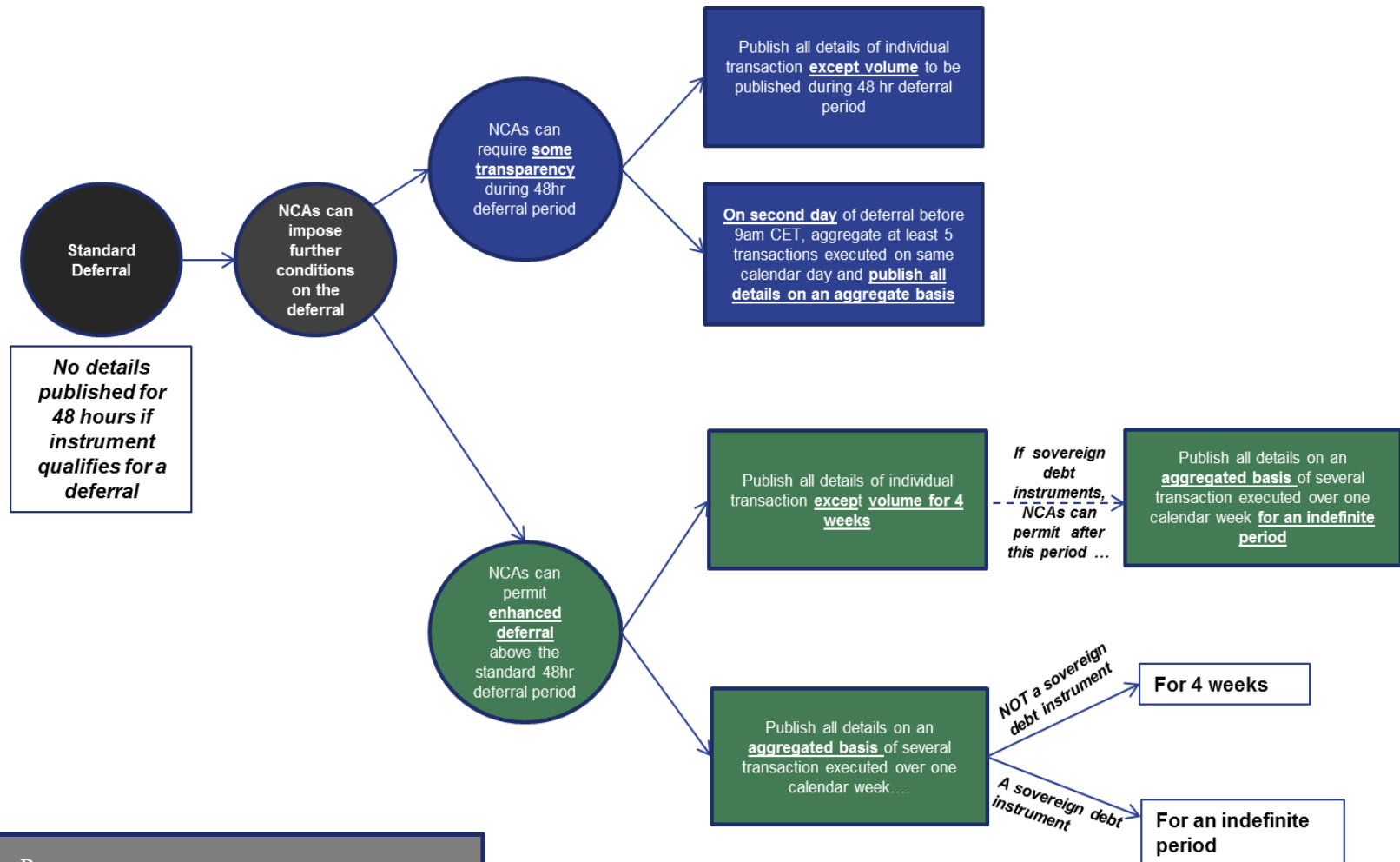
AGRICULTURAL COMMODITY OPTIONS - LIQUID CLASSES		
UNDERLYING	LIS (€)	SSTI (€)
Cocoa	13,000,000	6,500,000
Coffee	3,500,000	1,750,000
Corn	1,000,000	500,000
Rapeseed	19,000,000	9,500,000
Wheat (milling)	2,000,000	1,000,000

RTS9, Annex III - Table 44: Agricultural commodity options – illiquid classes

AGRICULTURAL COMMODITY OPTIONS - CLASSES NOT HAVING A LIQUID MARKET		
OTHERS	LIS (€)	SSTI (€)
	1,000,000	500,000

Supplementary deferral regime at the discretion of NCAs

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