



# **The new EU regulatory framework for commodity derivatives & MiFiD II/MiFIR implementation**

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Banking  
and finance

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## Presentation outline

- Motivation for post-crisis reforms
- Commodities regulatory framework
  - MIFID II / MiFIR
  - Market Abuse Regulation (MAR)
  - Benchmarks Regulation (BMR)



# MiFID legal acts

COM, EP,  
Council

- MiFID II/MiFIR (2011-2014) = Level 1
- Entry into force on 2 July 2014 and entry into application on 3 January 2018
- Around 90 empowerments for DA, RTS, ITS – Level 2 measures

ESMA

- ESMA technical advice – Dec 2014 – Delegated Acts
- ESMA draft RTS (Sept 2015)/ITS (January 2016)

COM  
EP, Council

- Delegated acts
- RTS and ITS



# The MIFID review: main objectives

- **Close loopholes** and achieve more efficient markets by shifting trade on to multilateral and transparent platforms in line with G20 consensus
- Improve oversight and transparency of **commodity derivative markets to ensure their function for hedging and price discovery**
- Ensure fair competition and **efficient markets**
- Updates required in light of developments in **market structures and technology**
- Raise **investor protection** in specific areas to support confidence
- Increase supervisory convergence across the single market and harmonise third country regime;
- **Improve capital markets to the benefit of the real economy**



# Key achievements of MiFID II

## **Scope:**

**Transparency**

**Algorithmic trading/HFT**

**Commodities**

## **Market Structure:**

**OTF**

**Trading obligation for derivatives**

**SME Growth Markets**

## **Investor protection:**

**Quality Enhancement**

**Inducements**

**Safeguarding of Client assets**



# Implications for financial markets regulators

*Commodity derivatives traded mostly OTC:*

- *Opaque Markets*
- *Lack of transparency in price setting*
- *Lack of supervision and coordination between regulators*
- *High volatility*
- *Settlement and credit risk*

*Conclusions at G20 on regulatory reform of financial and commodity markets*

# Commodity Derivatives Regulatory Framework

## Regulatory Objectives

### Transparency

- Scope of instruments covered
- Trading on trading venues
- Position reporting
- Supervising large traders

### Market Integrity

- Market Abuse
- Link physical and financial markets
- Position Limits
- Financial Benchmarks

### Prudential

- Central Clearing
- Bilateral collateral





# **MIFID**

## **Main Commodity Measures**

- Increasing the scope of commodity derivatives covered by MIFID
  - Stricter delineation between financial & physical markets, inclusion of emission allowances
- Increasing the scope of commodity traders covered by authorisation requirements
  - Capture non-financial entities acting as financial entities
- Position Limit and reporting regime to enhance transparency and to combat market abuse



# Reducing exemptions for non-financial traders

- MIFID II restricts the scope of exemptions to capture non-financial companies where they act as financial ones.
- Commodity trader exemption: MIFID II does not apply to persons who:
  - Deal on **own account** including market making in commodity derivatives & emission allowances/derivatives (excluding persons who deal on account by executing client orders) OR
  - Provision **of investment services** in commodity derivatives & emission allowances/derivatives to the customers or suppliers of main business;
  - Provided that it is an **ancillary activity** to their main business when considered on a group basis; and
  - **Main business** is not the provision of investment services or banking services, or acting as a market-maker in relation to commodity derivatives
  - No high frequency algorithmic trading technique



# Position limits/ management/reporting

- Main features:
  - NCAs to set net position limits that any person can hold in commodity derivatives at all times
  - A EU harmonised regime: ESMA sets methodology , as enshrined in RTS and monitors implementation
  - Position-reporting obligation by category of trader
  - Additional safeguards through position management controls by trading venues
- Objectives of position limits
  - Prevent market abuse
  - Support orderly pricing and settlement conditions, including preventing market distorting positions



# Position limits

- Contracts within scope :
  - **All exchange traded commodity derivatives**
  - **Economically equivalent OTC contracts**
- Hedging exemption:
  - **Positions held by a non-financial companies objectively measurable as reducing risks directly related to their commercial activity.**
- Limits set
  - **By contract, spot month non-spot month**
  - **At a net-basis**
- Limits imposed on "persons"
  - **Ultimate client concerned – also if exempt under MIFID**
  - **Positions are aggregated at group level**



# Position reporting

- **Commitment of trader reports:**
  - **For exchange traded derivatives, trading venues to publicly report weekly (aggregation) by categories of persons**
  - **For both exchange traded derivatives and OTC a complete break-down of positions held by all persons to NCAs at least daily**
- **Position reports to regulators:**
  - **Members, participants (RM, MTF) and clients (OTF) to report to the trading venues their own and end-client's position at least daily**

## EU Market abuse framework - recap

1. Market Abuse Regulation (**MAR**) and Criminal Sanctions for Market Abuse Directive (**CSMAD**) – applies as of July 2016
2. Enlarged scope (not to be confused with scope exemptions)
  - Commodity derivatives
  - Spot commodity contract
  - Benchmarks
  - Emission allowances – to qualify as "financial instruments" under MiFID as of 3 January 2018

# EU Market abuse framework - recap

## 1. Inside information in relation to commodity derivatives (MAR Art 7(1)(b)):

- 1) information of a precise nature,*
- 2) which has not been made public,*
- 3) relating, directly or indirectly to one or more such derivatives or relating directly to the related spot commodity contract, and*
- 4) which, if it were made public, would be likely to have a significant effect on the prices of such derivatives or related spot commodity contracts, and*
- 5) information which is **reasonably expected to be disclosed or is required to be disclosed** in accordance with legal or regulatory provisions at EU or national level, market rules, contract, practice or custom, on the relevant commodity derivatives markets or spot markets*

## 2. ESMA Guidelines on information relating to commodity derivatives markets or related spot markets

## EU Market abuse framework - recap

### 3. Market manipulation examples - related spot commodity contract (MAR Article 12(1)):

*1 - entering into a transaction, placing an order to trade or any other behaviour which:*

*(i) gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a financial instrument, a related spot commodity contract or an auctioned product based on emission allowances; or*

*(ii) secures, or is likely to secure, the price of one or several financial instruments, a related spot commodity contract or an auctioned product based on emission allowances at an abnormal or artificial level; **unless** ... for legitimate reasons, and conform with an accepted market practice;*

### 4. MAR Annex I - Indicators of Market Manipulation – Delegated Regulation (EU) No 2016/522

### 5. Cooperation and exchange of information relating to agricultural commodities – MAR Article 25(1)





# Benchmark Regulation - recap

- **Implements international IOSCO principles**
- **Broad scope**
- **All indices used:**
  - in financial instruments,
  - financial contracts or
  - for the performance of investment funds
- **Authorisation and supervision**
  - authorisation and supervision of administrators by national competent authorities
  - closing the regulatory gap
- **In force since 30/6/2016. Applies from 1/1/2018. Transitional provisions**

# Benchmark Regulation- recap

- **Administrator Requirements**
  - Organisational, governance requirements, accountability and record retention mechanisms
  - Methodology and input data
  - Transparency
  - Monitoring of input data
- **Contributor requirements**
  - Code of Conduct- controls on how to input data
  - Supervision for regulated entities
- **Specific Sectorial requirements**