7th ETRC 2017 SUMMIT

ENERGY TRADING REGULATIONS & COMPLIANCE

Presentation: Commodity traders and MiFID II: What now?

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COMMODITY TRADERS AND MIFID II: WHAT NOW?

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1 SOME REGULATORY PERSPECTIVES

2 COMPLIANCE ASPECTS

3 EVALUATING OPTIONS

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Setting the frame: the regulatory patchwork

- MiFID II:
  - art. 2.1 (j): ancillary activity exemption
  - Art 57: position limits
  - Annex I, Section C 4-11: definitions
- Regulatory Technical Standards:
  - RTS 20: ancillary activity exemption
  - RTS 21: position limits
  - ??: further definition of financial instruments
- ESMA guidelines and Q&As

SOME REGULATORY PERSPECTIVES

FOCUS: DEFINITION OF FINANCIAL INSTRUMENTS

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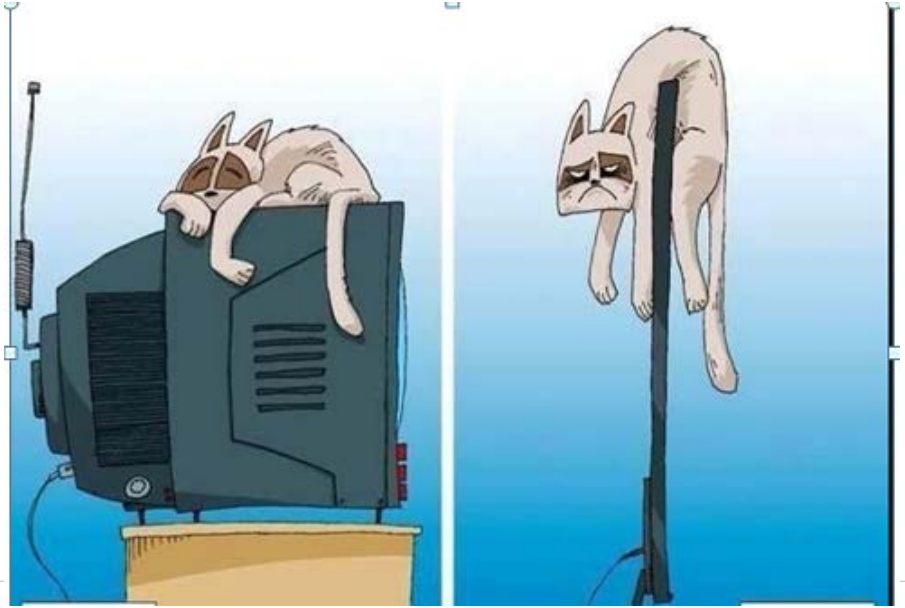
Changes: the broad picture

- New definitions of financial instruments;
- New MiFID exemption on ancillary activity;
- More trading rules and obligations



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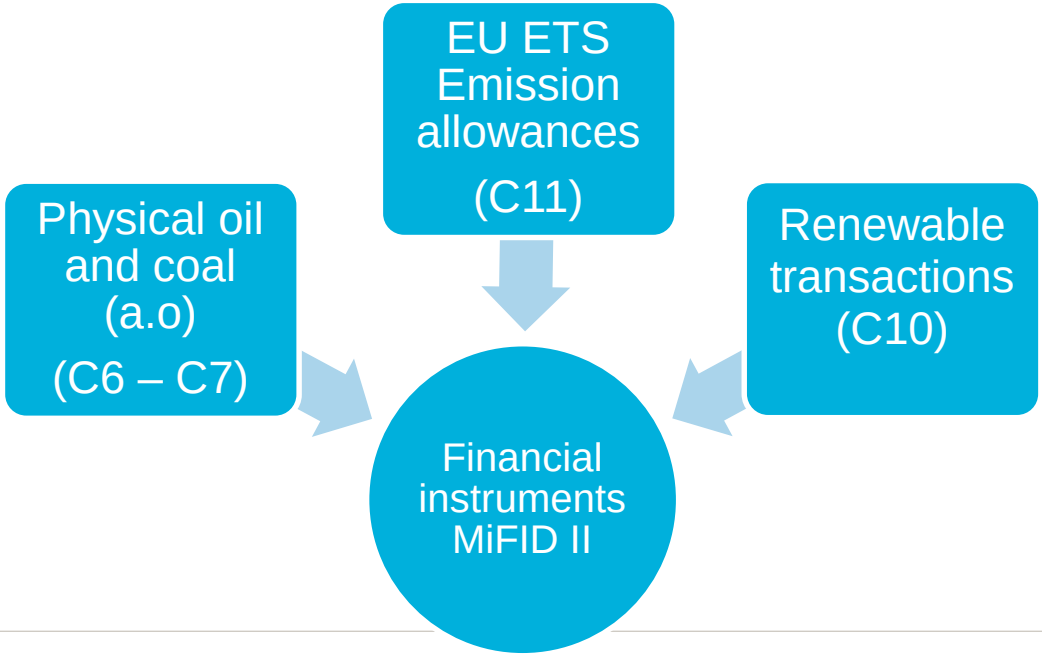
Shift in definitions of financial instruments

- Financially settled transactions remain financial instruments
- More physically settled transactions come into scope of financial regulations:



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What remains a physical commodity?

- All commodity spot contracts
- REMIT carve out for power and gas
  - Take or Pay
  - Physically settled options
  - Netting (close out, payment, operations)
- Wholesale energy products

Immediate Consequences of new definitions

- Any change in MiFID's definitions will change EMIR's impact:
  - Closely related definitions
  - More transactions caught by EMIR's compliance requirements
  - Changes in GNV calculation and possibly in counterparty status

- Any change in MiFID's definitions will change the scope of MAR:
  - Emission allowances (all) will be integrated into MAR
  - Brokered contracts will fall under supervision through the OTF category

First reactions in the markets

- Using the REMIT carve out:
  - New OTF platforms
  - How sustainable are they?

- Closing out financial contracts and hedging with physical forwards

- Moving to exchange traded contracts:
  - OUT: EMIR compliance
  - IN: MiFID risk

COMPLIANCE ASPECTS

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Increased documentation requirements

- Definitions of financial instruments
  - In particular for complex non standard transactions
- Ancillary activity exemption:
  - Yearly notification to the NRAs (and if requested: evidence)
- Position limits
  - Documentation of risk reducing positions
  - Documentation of internal controls

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Increased processes

- Day to day monitoring of trading books :
  - AAE calculations
  - Position limits
    - Depending on asset classes and trading within day or live monitoring?
- Proactive identification of risk reducing positions:
  - Need verification of all new trading strategies and ventures to enable immediate identification and justification of risk reducing transactions
- Increased reporting obligations
  - Directly from MiFIR
  - Indirectly through EMIR and other regulations foreseeing reporting of financial instruments

What alternatives exist?

- How about trading on foreign market places instead of EU venues?
  - Trading through a EU (consolidated) entity abroad
  - Trading through non EU non consolidated entity
- Do long term alternatives exist?

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EVALUATING OPTIONS

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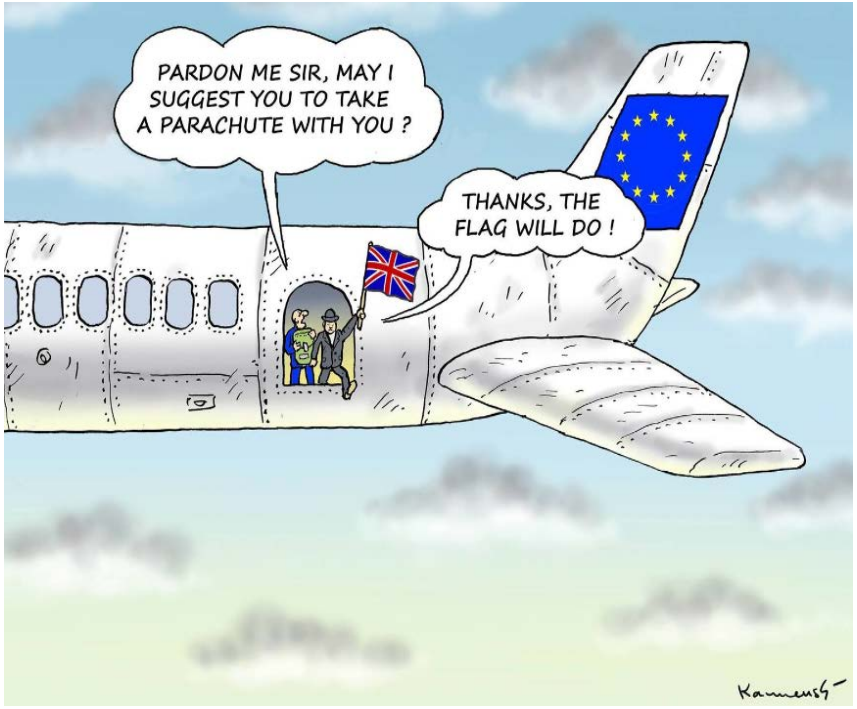
Going the MiFID route

- Licensing
  - More compliance requirements apply
    - Full MIFID II organisational requirements
    - Business conduct requirements
    - MiFIR requirements
    - “CRD” requirements
    - EMIR increased compliance
  - Clear advantage that trading is not limited by regulations

Will the following change the picture?



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THANK YOU

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Slido questions

Anya has kindly accepted to provide her non binding opinion on the slido questions that remained unanswered due to lack of time after her presentation at ETRC.

You will find them in the next 3 slides.

Please bear in mind that the **Chatham House rule applies to the whole presentation as well as to the answers Anya provided** to the slido questions.

Thank you,

The IRN Team

Slido questions 1/3

- **Will the hedging exemption for position limits (*need*) to be filed for all the hedging positions or only when close to the limit?**

There is no specific mention in the Directive or the RTS, as to the time one has to apply for the hedging exemption.

Nevertheless, the wording used in Art. 57 could lead to the conclusion that the exemption needs to be applied for "ex-ante" : "Position limits shall not apply to positions held […] which are objectively measurable as reducing risks directly relating to the commercial activity of that non financial entity".

As position limits don't apply to "hedging positions", these might have to be exempted immediately, but further clarifications in level 3 text would be useful.

Slido questions 2/3

- **Could a non EU venue list European wholesale energy products? Would these products still be outside the EU GNV market share calculation?**

I don't believe this would be the case.

The REMIT carve out works on the following assumptions: the transaction concerns "Wholesale Energy Products" as defined in REMIT (i.e power and gas in the EU), and the transaction takes place on an OTF.

Where power and gas are traded on a third country venue, none of the conditions is met. The products are not wholesale energy products and the venue is not an OTF but a third country venue equivalent to an OTF. It is hence likely that these products qualify as financial instruments under Annex I Section C7, combined with Art. 7.1 of the Delegated Regulation.

Slido questions 3/3

- **Could the London-based power & gas brokers move part of their operations to the continent, to attain OTF standard?**

In my view yes, absolutely.

- **Does the RTS20 capital employed test only apply to EU trading activity?**

The RTS seem to indicate that the numerator of the capital employed test is to be measured as the other tests, based on the activity "undertaken in the Union".

The denominator of the test is for its part based on the total assets of the Group (assessed on the consolidated financial statements).

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