Ref. Ares(2013)2567401 - 03/07/2013

MiFID Trialogue Briefing: Commodity Speculation – Amendments Still Required

02/07/2013

Civil society organisations have been calling for greater transparency and limits on speculation on food and other commodities in order to prevent excessive speculation contributing to price spikes and volatility.

While efforts by the European Parliament (EP) and Council have strengthened the original proposals, the current versions of the text all fall short of what is required to achieve this. This briefing sets out how a stronger compromise text could be built drawing on parts of all three texts.

Summary

Strengths of the EP text:

- Limits would be set at EU level (based on standards from ESMA);
- No exemption from limits for “treasury financing activity”;
- Limits apply to both cash- and physically-settled contracts;
- Specified that limits should be used to preventing market distortion and disruption of price discovery function

Weaknesses of the EP text:

- Limits would only be applied to exchange-traded contracts, increasing incentives for OTC trading;
- It is unclear whether limits would be applied to all months of a contract;
- Limits only apply to a trader’s net position;
- Specifies that limits should be used to “support liquidity”, risking them being set excessively wide.

Strengths of the Council text:

- Limits not restricted to exchange-traded contracts (however, the text should make it explicit that OTC contracts are also covered);
- Limits applied by competent authorities;
- Limits not restricted to net positions (however, the text should make it explicit that they will apply to both net and gross positions);
- Provision for limits to “support liquidity” has been deleted.

Weaknesses of the Council text:

- Limits would be established at member state level, risking a race-to-the-bottom on weak limits;
- Exemption for “treasury financing activity” is unnecessary and would allow speculative contracts to be exempt from the limits;
- Text implies limits for cash-settled contracts would be weaker than physically-settled contracts, and would not necessarily apply to all months of contracts.

Strengths of both texts:

- Require limits in addition to position management/checks, not as an alternative;
- Differentiate between trading for hedging and speculative purposes.

Weaknesses of both texts:

- Do not allow for limits on a group of traders, or the total amount of speculation;
- Inadequate transparency.

For further explanation of why further amendment is required, see also the briefing at www.foeeurope.org/sites/default/files/makefinancework_mifid_loopholes_june2013.pdf.

Text comparison

Notes: All text is MiFID art 59 unless otherwise stated.
Bold type highlights where strengths or weaknesses occur in existing text; in recommended amendments, italics show key wording; strikethrough shows deletions.

1. Limits must be established at **EU level** (applied by competent authorities) to prevent race-to-the-bottom of member states setting the weakest limits to attract extra trade.

Commission text	Council text	Parliament text	Recommended amendment
1. Member States shall ensure that **regulated markets, operators of MTFs and OTFs** which admit to trading or trade commodity derivatives **apply** limits… 3. The **Commission** shall be empowered to adopt **delegated acts** in accordance with Article 94 **to determine the limits** or alternative arrangements on the number of contracts which any person can enter into over a specified period of time…as well as the conditions for exemptions.	1. Member States shall ensure that **competent authorities establish** and apply position limits… 7. **ESMA** shall develop **draft regulatory technical standards** to **determine the criteria** that competent authorities will apply in establishing the position limits…	1. Member States shall ensure that **regulated markets, and operators of MTFs and OTFs** which admit to trading or trade commodity derivatives **apply** limits… 3. **ESMA** shall draft **regulatory technical standards to determine the limits** referred to in paragraph 1…	Member States shall ensure that ***competent authorities apply*** position limits… ***ESMA*** shall draft ***regulatory technical standards*** to ***determine the limits*** that ***competent authorities will apply***.

2. Limits must cover both **OTC and exchange-traded** contracts to avoid incentivising opaque OTC trading.

Commission text	Council text	Parliament text	Recommended amendment
1. Member States shall ensure that **regulated markets, operators of MTFs and OTFs** which admit to trading or trade commodity derivatives **apply limits**…	1. Member States shall ensure that **competent authorities establish** and apply position limits…	1. Member States shall ensure that **regulated markets, and operators of MTFs and OTFs** which admit to trading or trade commodity derivatives **apply** limits…	Member States shall ensure that ***competent authorities*** apply position limits to all commodity derivatives traded on regulated markets, MTFs or OTFs ***or outside a trading venue***.

3. **No exemption for "treasury financing activity"** – the only trading that should be exempt from the limits is genuine physical hedging.

Commission text	Council text	Parliament text	Recommended amendment
[no mention of this exemption]	1…Position limits **shall not apply to** positions objectively measurable as reducing risks directly related to the commercial activity or **treasury financing activity of a non-financial entity or of a person who acts on behalf of that non-financial entity.**	1…They [the limits] shall not apply to positions which in an objectively measurable way reduce risks directly related to commercial activities. [no mention of this exemption]	Limits shall not apply to positions which in an objectively measurable way reduce risks directly related to commercial activities ~~*or treasury financing activity of a non-financial entity or of a person who acts on behalf of that non-financial entity*~~.

4(a). **Equivalent limits for cash- and physically- settled contracts** to prevent increased speculation with cash-settled contracts.

Commission text	Council text	Parliament text	Recommended amendment
[no mention of this]	7… In developing the regulatory technical standards, ESMA shall take account of, at least, the following: (a) **whether** the financial instruments can be **physically settled or are cash settled**;	1… The limits referred to in the first subparagraph shall **apply to both physically and cash settled contracts**	The limits referred to in the first subparagraph shall apply to both physically and cash settled contracts, *and* ***not be higher for cash-settled contracts*****.**

4(b). **Limits for all months** of contracts to prevent prices being distorted through trading contracts prior to the delivery month.

Commission text	Council text	Parliament text	Recommended amendment
[no mention of this]	7… In developing the regulatory technical standards, ESMA shall take account of, at least, the following: (b) the **maturity** of the commodity derivative contracts;	[no mention of this]	The limits shall specify clear quantitative thresholds ***for spot, single and all delivery periods combined*** that persons can enter into or hold over a specific period of time.

5. **Limits for net and gross positions** to avoid traders circumventing limits.

Commission text	Council text	Parliament text	Recommended amendment
[no mention of this]	[no mention of this]	1…They shall specify clear quantitative thresholds such as the maximum **net** position persons can enter into or hold over a specific period of time.	They shall specify clear quantitative thresholds such as the maximum net ***and gross*** position persons can enter into or hold over a specific period of time.

6. **Purpose of limits** clearly to prevent price distortion due to excessive speculation, and not to "support liquidity".

Commission text	Council text	Parliament text	Recommended amendment
1. Member States shall ensure that regulated markets, operators of MTFs and OTFs which admit to trading or trade commodity derivatives apply limits…in order to: **(a) support liquidity;** (b) prevent market abuse; (a) (c) support orderly pricing and settlement conditions.	1. Member States shall ensure that competent authorities establish and apply position limits…in order to: **(a) deleted.** (b) prevent market abuse; (c) support orderly pricing and settlement conditions.	1. Member States shall ensure that regulated markets, and operators of MTFs and OTFs which admit to trading or trade commodity derivatives apply limits…in order to: (a) **support liquidity;** (b) prevent market abuse; (c) support orderly pricing and settlement conditions; (d) **promote convergence between prices in of derivatives in the delivery month and spot prices for the underlying commodity, without prejudice to price discovery in the market for the underlying commodity;** (e) **prevent the build-up of market distorting positions.**	Member States shall ensure that competent authorities apply position limits…in order to: ***(a) deleted*** (b) prevent market abuse; (c) support orderly pricing and settlement conditions; ***(d) promote convergence between prices in of derivatives in the delivery month and spot prices for the underlying commodity, without prejudice to price discovery in the market for the underlying commodity;*** ***(e) prevent the build-up of market distorting positions.***

7. **Limits must apply not only to individual, but also to group of traders**. To avoid companies split positions to avoid limits, also **aggregation of positions is crucial**.

Commission text	Council text	Parliament text	Recommended amendment
[no mention of this]	[no mention of this]	[no mention of this]	Member States shall ensure that competent authorities apply ***aggregated*** position limits to all commodity derivatives traded on regulated markets, MTFs or OTFs or outside a trading venue. Position limits shall limit the size which a person ***or all persons belonging to one trader category*** can have over a specified period of time.

8. **Complete and automatic transparency.**

Commission text	Council text	Parliament text	Recommended amendment
1. Member States shall ensure that regulated markets, MTFs, and OTFs which admit to trading or trade commodity derivatives or emission allowances or derivatives thereof: (a) make public a weekly report with the aggregate positions held by the different categories of traders for the different financial instruments traded on their platforms in accordance with paragraph 3; (b) provide the competent authority with a **complete breakdown of the positions** of any or all market members or participants, including any positions held on behalf of their clients, **upon request.** The obligation laid down in point (a) shall **only apply when** both the number of traders and their open positions in a given financial instrument **exceed minimum thresholds**.	1. Member States shall ensure that an investment firm or a market operator operating a trading venue which trades commodity derivatives or emission allowances or derivatives thereof: (a) make public a weekly report with the aggregate positions held by the different categories of position holders for the different financial instruments traded on their platforms specifying the number of long and short positions by category of position holder, changes thereto since the previous report, the percentage of the total open interest represented by each category and the number of position holders in each category in accordance with paragraph 3; (b) provide the competent authority with a **complete breakdown of the positions** of any or all position holders, including the members or participants and the clients thereof, on that trading venue, **upon request**. The obligation laid down in point (a) **shall only apply** when both the number of position holders and their open positions in a given financial instrument **exceed minimum thresholds**.	1. Member States shall ensure that regulated markets, MTFs, and OTFs which admit to trading or trade commodity derivatives or emission allowances or derivatives thereof: (a) make public a weekly report with the aggregate positions held by the different categories of traders for the different financial instruments traded on their platforms in accordance with paragraph 3 and communicate this report to the competent authority and to ESMA ; (b) provide the competent authority with a **complete breakdown of the positions** of any or all market members or participants, including any positions held on behalf of their clients, **upon request**. The obligation laid down in point (a) **shall only apply** when both the number of traders and their open positions in a given financial instrument **exceed minimum thresholds**.	Member States shall ensure that an investment firm or a market operator operating a trading venue which trades commodity derivatives or emission allowances or derivatives thereof: (a) make public a weekly report with the aggregate positions held by the different categories of position holders for the different financial instruments traded on their platforms specifying the number of long and short positions by category of position holder, changes thereto since the previous report, the percentage of the total open interest represented by each category and the number of position holders in each category in accordance with paragraph 3 and communicate this report to the competent authority and to ESMA; (b) provide the competent authority with a complete breakdown of the positions of any or all market members or participants, including any positions held on behalf of their clients, ***on a daily basis***. ~~*The obligation laid down in point (a) shall only apply when both the number of traders and their open positions in a given financial instrument exceed minimum thresholds.*~~