SOMO

Stichting Onderzoek Multinationale Ondernemingen

Centre for Research on Multinational Corporations

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Attn. Ms Nadia Calviño,
Deputy Director General
Directorate-General Internal Market and Services
European Commission
B-1049 Brussels
Belgium

Amsterdam. 13 December 2012

Ref: Revision of MiFID : challenges for regulators in the commodities derivatives markets

Dear Ms Calviño,

The current EU legislative process to revise MiFID (Market in Financial Instruments Directive) at the level of the Council of Finance Ministers and trilogue, deals among others with trading venues for commodity derivatives.

The MiFID review takes place at a time when financial players on the (food) commodity derivatives markets are introducing new, complex and risky strategies. These new trends are explained in the enclosed research paper published by SOMO, a non-profit research centre. For instance:

- Hedge funds owned by commodity traders are not transparent and their activities risk blurring hedging and speculative positions.
- Different kind of (food) commodity (index) ETFs (exchange traded funds) have increased dramatically since 2008, managing around US$ 180 bn. They are increasingly using new more risky, dynamic and ever shorter term strategies.
- Financial players who speculate on (food) commodity prices are very interconnected with the rest of the financial markets, which constitutes an underestimated systemic risk for the financial system.

These new trends of increased complexity and risk-taking in the commodity derivatives business challenge regulators on how to be take them into account in order to ensure effective regulation of MiFID-II/MiFIR, UCITS (VI), TRIPs and indices. The SOMO research paper concludes with the following recommendations on how loopholes and regulatory arbitrage can be avoided during the current regulatory processes:

- **Position limits need to be defined and imposed at EU level (ESMA) and not at national level** in order to avoid regulatory arbitrage and loopholes.
- **Position limits** on **OTC commodity derivatives are needed** as OTC derivatives are often used by commodity ETFs and hedge funds in a speculative strategy (sometimes in combination with commodity derivatives traded on traded venues, or even with physical commodity trading). Position limits on OTC commodity derivatives should be clearly incorporated in Art. 59.1 of MiFID II.
- **Position limits need to be applicable for each month during the derivatives contract** since the roll-over of contracts by financial players, such as commodity index funds, become more dynamic (i.e. happen not only during the delivery month).

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- **As little as possible exemptions should be granted** to avoid unforeseen loopholes made possible by using the increasingly complex strategies, and due to lack of transparency by financial players who also cooperate with physical commodity traders. For instance, the "treasury financing activity of a non-financial entity" should not be exempted from position limits.
- ESMA as well as national competent authorities and trading venues responsible for **supervision and position management controls need sufficient resources and knowledge about physical commodity markets.** This should allow them to deal with the increasing risk of blurring between a bona fide hedging position and a financial speculative position, and strategies combining physical and derivatives commodity markets. Amongst others, national competent authorities should be consulting with the public bodies competent for the oversight of administration and regulation of physical agricultural markets under 1234/2007/EC in case the measure relates to agricultural commodities derivatives (under MiFIR, ESMA is getting a similar mandate).

In order to ensure that legislators, academics, and other stakeholders can continue to monitor whether the regulation is effective, the final revised MiFID text should contain the EP's position (MiFID II text voted by the EP plenary, Art. 60.5.a.) that **ESMA should weekly publicly report in a centralised way the aggregate positions** held by the different categories of traders for the different financial instruments traded on all EU trading venues.

Effective regulation needs to aim at protecting the integrity of the physical and derivatives commodity markets and preventing undue volatility and price hikes that harm poor food importing countries that dependent on commodity exchanges as price bench marks. The MiFID revision is also important in the context of price uncertainty that will increase due to the reform of the common agricultural policy (PAC), and might result in more EU agricultural producers and processors using agricultural commodity exchanges.

Please do not hesitate to contact me if you have any questions or comments,

Yours sincerely, [redacted]

[redacted]
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Enclosed: "Challenges for Regulators - Financial Players in the (Food) Commodity Derivatives Markets", SOMO Briefing paper, November 2012. This SOMO briefing paper can be freely distributed and downloaded at: http://somo.nl/publications-en/Publication_3898

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Stichting Onderzoek Multinationale Ondernemingen

Centre for Research on Multinational Corporations

Attn:
Ministry of Finance
Unit financial markets and/or EU financial legislation
(officials responsible for negotiating MiFID / MiFIR)

Amsterdam, 13 December 2012

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Yours sincerely,

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