MiFID II quick-fix commodity proposals
(20.10.2020)

We, the signatory associations, fully **support** the European Commission's proposals amending Directive 2014/65/EU (MiFID II) with regard to commodity markets, as part of the larger Capital Markets Recovery Package adopted on 24 July 2020, but clearly **reject** the proposed amendments of the Committee on Economic and Monetary Affairs (ECON) of the European Parliament on the amendment of Directive 2014/65/EU with regards to commodity markets. The Commission's proposals substantially reduce the compliance burdens as they simplify the MiFID II commodity regime and allow European companies to cover their commercial risks, whilst continue to fully safeguard the transparency and integrity of commodity markets. The proposed measures also ensure the liquidity of the EU wholesale commodity markets and support a recovery of the real economy from the severe economic damage caused by the COVID 19 pandemic.

We are very concerned, however, that the proposed amendments by ECON will lead to either substantial narrowing of this exemption or make it seemingly impossible to rely on it, as some amendments **reject the entire** proposal by the Commission. We consequently **reject** the amendments (43,44,45,46,63,64,65,66,67 and 68) as they effectively fail to meet the criteria to ensure a well-functioning commodity market which is needed to ensure a green Recovery of the European economy and the energy transition.

Please find below our detailed comments:

We remain very supportive of the simplification of the Ancillary Activity Exemption (AAE) under MiFID II as proposed by the European Commission. Under this AAE, commodity firms remain exempted from MiFID II licensing requirements if their own account trading activity and provision of investment services are ancillary to their main business, when considered on a group basis. Signatory associations and their membership welcome the intended simplification and currently exempted non-financial firms are confident that they can continue to rely on the amended AAE.

In our view, any further improvement of the AAE, if co-legislator deem that necessary, should be agreed by the co-legislators and directly embedded in the Level 1 Text of Article 2(1) (j) of MiFID II and such political decision should not be delegated to and taken by ESMA through the draft and adoption a Regulatory Technical Standard to specify the AAE (RTS). Granting a mandate to ESMA to define qualitative criteria of the ancillary test may lead to a more complicated test instead of simplifying it, which is the intention of the Commission proposals.

In general, a narrow interpretation or design of the AAE or keeping the status quo as suggested in the proposed Amendments would lead to commodity firms currently relying on the exemption having to become MiFID II authorized, despite not having changed the way they conduct their business. We believe the Commission's intention is to simplify the test rather than to change the current *status quo*. This would lead to several unintended consequences:

- This would reduce the ability for firms to invest in the decarbonisation of the European economy and endanger the long-term goal of the "European Green Deal" of the European Commission. We believe that money tied up with the regulatory capital and margining requirements is much better used in investment in energy infrastructure and decarbonisation projects, to make the EU energy sector sustainable in alignment with the "European Green Deal".
- This would put the EU27 commodity firms at a material competitive disadvantage *vis-a-vis* 3rd country firms, as commodity firms outside the EU can perform relative simple tests or may not be required to be regulated as investment firms, for example commodity firms in Singapore, the USA, Switzerland and in the UK after Brexit. EU27 commodity firms would have to comply with burdensome and costly requirements under financial regulation, such as licensing, capital and margining/collateralization requirements.
- The current AAE has a Market Size Test at its core. This will need to be revised, especially if, having left the EU, the UK does not agree a relationship for financial services addressing this exemption. *ESMA stated in its MiFID II review report on position limits and position management of 1st April 2020 (hereinafter: "ESMA MiFID review report") that it "shares the views expressed by stakeholders on the impact of Brexit on the MiFID II framework for commodity derivatives and the ancillary activity exemption*" and, therefore, "*strongly encourages the EC to take the opportunity of the earliest possible amendment to MiFID II to review the ancillary activity exemption and the criteria thereof*[1]." Some of the proposed amendments suggest keeping the test the same and overlook this important fact and the adverse implications, which would mean that many EU27 real economy markets participants would end up being authorised under MiFID II.

[1] ESMA's MiFID II review report on position limits and position management (1 April 2020 – "ESMA MiFID Review Report"), p. 39, nos. 138 and 139.

- Indeed, a change of the *status quo* caused by a narrow interpretation of the exemption is likely to force energy firms to curtail or stop their EU trading activity, or, where possible, to trade *via* other international markets. The consequential fall in liquidity in EU27 commodity and commodity derivatives markets would significantly increase the costs of risk management for the real economy and severely hamper the ability to hedge the commercial risks efficiently. Subsequently, this would expose EU27 commodity traders, as well the real economy, to increased risks in volatile markets (e.g. COVID-19) and result in higher end consumer commodity (e.g. gas and power) prices.

- Furthermore, damage to wholesale energy markets directly undermines the political aims such as the completion of the internal European energy market. Illiquid wholesale markets would reduce market competition and efficiency in production and retail markets and prices for consumers and industry can be expected to increase as a result. Higher risk, constrained investment capital and poor market price signals would significantly undermine investment, production and consumption decisions and reduce security of supply.

- All these increased costs and risks come without additional improvement of the risk profile or integrity of the energy and financial markets. Energy markets are already effectively regulated, transparent and subject to the same high standards of conduct and integrity and are not of systemic relevance for the wider financial markets.

- Finally, a narrow understanding of the AAE would, in the end, harm several political aims of the EU, which are to strengthen the competitiveness of the EU commodity markets, to ensure the development of Euro dominated EU commodity markets and enable firms to support the European Green Deal through sustainable investments.

For these reasons we believe it is of paramount importance that the co-legislators simplify the AAE as proposed by the European Commission while keeping the current scope of the AAE in place to avoid the above-mentioned unintended adverse consequences. Again, we believe that this political decision, including an EU-wide harmonised implementation of the AAE, should be taken by the co-legislators themselves and not be delegated to ESMA.

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