EFET responses to ESMA MiFID II/ MiFIR Discussion Paper and Consultation Paper

Discussion Paper response: pages 2 to 58

Consultation Paper response: pages 59 to 80

EFET Market Supervision Committee **31 July 2014**

EFET Reply to ESMA MiFID II/ MiFIR Discussion Paper

3. Transparency

3.11. The Trading Obligation for Derivatives

Q168: Do you agree that there should be consistent categories of derivatives contracts throughout MiFIR/EMIR?

Yes, EFET agrees that there should be consistency between EMIR and MiFIR; this would facilitate the implementation process for market participants.

Q169: Do you agree with this approach to the treatment of third countries?

Yes, EFET agrees with an approach consistent with EMIR.

Q170: Do you agree with the proposed criteria based anti-avoidance procedure?

Yes.

Q171: Do you think it would be reasonable for ESMA to consult venues with regard to which classes of derivatives contracts are traded on venue? Do you think venues would be well placed to undertake this task?

Yes. Especially in the commodities area where there is a very wide list of products with a high level of complexity, it is essential to consult venues (Exchanges & Brokers associations), as they are best placed to share experience and procedures on product approval and liquidity tests.

Q172: The discussion in section 3.6 on the liquid market for non-equity instruments around 'average frequency', 'average size', 'number and type of active market participants' and average size of spreads is also relevant to this chapter and we would welcome respondent's views on any differences in how the trading obligation procedure should approach the following:

i. Frequency alone is not sufficient to assess liquidity, but must be combined with other criteria, like trade size and price spreads.

ii. Again, with commodities a case by case approach is needed, due to the underlying complexity, i.e. see the product description of commodity products listed by EEX or ICE.

iii. As indicated in Art. 32 3. b), the number and type of active market participants needs to be included too.

Q173: Do you have a view on how ESMA should approach data gathering about a product's life cycle, and how a dynamic calibration across that life cycle might work? How frequently should ESMA revisit its assumptions? What factors might lead the reduction of the liquidity of a contract currently traded on venue? Are you able to share with ESMA any analysis related to product lifecycles?

The methods of data gathering regarding product's life cycle should be developed with existing venues, to base the rules on existing market practices, which have proven their validity, and to avoid mistakes that may have been made by existing venues implementing their models.

4. Microstructural issues

4.3. Organisational requirements for trading venues (Article 48 MiFID II)

Q229: Do you agree with requiring trading venues to perform due diligence on all types of entities willing to become members/participants of a trading venue which permits algorithmic trading through its systems?

In general EFET agrees with requiring trading venues to perform due diligence. But, due to the staff selection policy and training practice EFET doubts that these will prevent people from making mistakes and perhaps market manipulation (it is a false security and leads to more bureaucracy). Regarding being more stringent to non-investment firms and non-credit institutions EFET is of the opinion that all entities shall adhere the same set of rules (not to discourage other (smaller) companies to start trading businesses).

Q234: Do you agree with the above approach?

Sufficient capacity to accommodate reasonable foreseen volumes of messaging is needed. The proposed method to have at least twice the highest number of messages per second value ever recorded (historical view) does not take into account the need of capacity raise over a period of time (future view). Therefore, EFET suggests to add the method to estimation of volumes over the next 3/6/12 months.

Q244: Should trading venues have the ability to impose the process, content and timing of conformance tests? If yes, should they charge for this service separately?

No, any compatibility tests between trading venues and members/participants, especially during the deployment process of new functionalities, will extend development process and cause additional costs, time and resources. However, any additional costs will make market entry more difficult for company intending trading activities. Alternative means of conformance testing shall be admitted to give flexibility to the members/participants.

Q246: Could alternative means of testing substitute testing scenarios provided by trading venues to avoid disorderly trading conditions? Do you consider that a certificate from an external IT audit would be also sufficient for these purposes?

It would also be sufficient if external IT Audit is able to certify testing with adequate costs and time. EFET recommends to define standards for external IT audit to be fulfilled. Key minimum capabilities for establishing a testing environment are secure test environment representing the planned operations environment relative to security, internal controls, operational practise, data quality and requirements, and workloads.

Q254: Do you agree with the list of elements that should be published by trading venues to permit the provision of DEA to its members or participants?

EFET only agrees partly. The list of minimum standards (Trading venues' pre-determination of the conditions) to provide DEA is on a high level. These define more the category level, but the standard definition itself is not defined precisely. Key requirements are unclear. EFET recommends to provide more details before the association is able to assess the impact on its member companies' business.

Q258: Do you agree with the previous assessment? If not, please elaborate.

Compulsory Market Making for nearly all investment firms" (including NFCs exempted under Article 2(1)(j)) This proposal means for non-financial firms a substantial change compared to the current situation. The aim is to make the markets more robust against extern shocks and disruption. On the other hand this means higher effort and costs for the companies affected. EFET is of the opinion that the prerequisites for entering into market making agreements are to be defined narrowly and that content of market-making agreements should be determined pre-dominantly between the venue and a counterparty in detail and not by the regulator. If this regime is construed to restrictive and burdensome, any obligation to market make following a trade is likely to reduce market liquidity, not increase it, because firms will rather refrain from market making altogether. ESMA should therefore rather set general principles as regards the pre-requisites and content.

EFET agrees that the requirements in Article 17 and 48 of MiFID II in terms of market making agreements are correlated and should be addressed jointly.

Q262: Do you agree with the above assessment?

EFET agrees with the exclusion of indirect participants.

Q270: Do you agree with the list of requirements set out above? Is there any requirement that should be added / removed and if so why?

Ad vi (kill switch): The main question is whether this requirement is related to the application that is responsible for the respective Market Making in the defined Market place or whether it is related to all deals of the concerned firm. An application based kill switch is partially already available at firms, but a wider concept would require substantial effort for IT.
Ad vii: Remuneration is something that should be decided by firms only, EFET thinks that firms' current salary concepts are effective with regards to prevent disproportionate risk taking.

Q273: Should the presence of market making strategies during trading hours be the same across instruments and trading models? If you think it should not, please indicate how this requirement should be specified by different products or market models?

In the view of EFET this is too strict and inflexible, not all instruments should have the same regulation. For example, the status of liquidity should be taken into account.

Q275: Do you disagree with any of the events that would qualify as 'exceptional circumstances'? Please elaborate.

EFET agrees with the listed events. It is important for firms that technical issues (which occurred from time to time in the past) are a valid reason to interrupt the Market Making obligation.

4.5. Order-to-transaction ratio (Article 48 of MiFID II)

Q290: Do you agree with the types of messages to be taken into account by any OTR?

Yes.

Q292: Should any other additional elements be taken into account to calibrate OTRs? If yes, please provide an explanation of why these variables are important.

EFET agrees with the approach of ESMA.

Q293: Do you agree with the proposed scope of the OTR regime under MiFID II (liquid cash instruments traded on electronic trading systems)?

Yes.

Q294: Do you consider that financial instruments which reference a cash instrument(s) as underlying could be excluded from the scope of the OTR regime?

Yes.

Q296: Do you agree with considering within the scope of a future OTR regime only trading venues which have been operational for a sufficient period in the market?

Yes.

Q299: Do you agree with the proposal above as regards the method of determining the OTR threshold?

Yes.

6. Requirements applying on and to trading venues

6.1. Admission to Trading

Q461: Do you agree with the specifications outlined above for the suspension or removal from trading of derivatives which are related to financial instruments that are suspended or removed?

There should be the possibility of a transitional period to adapt investment and/or hedging strategies before the suspension or removal is executed.

7. Commodity derivatives

7.1. Ancillary Activity

Q464: Do you see any difficulties in defining the term ‘group’ as proposed above?

EFET agrees that the reference to the group definition in Article 2(11) of the Accounting Directive in Article 4(1) no 34 of MiFID II includes an EU parent undertaking and all its EU and non-EU subsidiary undertakings. Therefore, EFET agrees that this reference in the Accounting Directive can be understood as including all relevant global main business activities of all global group companies meeting the requirements for parent and subsidiary undertakings according to Articles 2(9), (10) and (11) and 22 of the Accounting Directive.

One can therefore deduce that the geographical scope of activities relevant for “the main business on a group basis” under MiFID II is generally not limited to the EU area, but rather that all global main business of all undertakings (EU and non-EU) should be considered. Consequently, also non-EU activities should be part of the main business on a group basis provided that these activities are related to hedging activities in the EU. This approach accommodates the circumstance that main commercial activities of commodity firms are often located outside the EU, such as oil and gas exploration facilities, but the hedging via commodity derivatives of the commodity price risk of this main business takes place in the EU for different reasons, for example because liquid trading places are available in the EU or to allow 24h operations in global markets.

However, EFET is of the opinion that it is necessary to distinguish between the definition of a “group” and the concept of "ancillary activities at a group level": Only ancillary activities conducted within the EU area, respectively, with a link to the EU are to be considered as “ancillary activities at a group level” because MiFID II can only aim to regulate (and exempt) those activities which are subject to its jurisdiction, i.e., activities within the EU area, and that the EU legislator will consequently have only wanted to include such activities. Such a link to the EU exists if the ancillary activity involves an EU counterparty or/and is executed over an EU trading venue/EU CCP. This assessment is supported by the fact that the legal basis for MiFID II is Article 53(1) of the Treaty on the Functioning of the European Union (TFEU) whose scope is limited to the EU (see recital 7 of MiFID II).

Q465: What are the advantages and disadvantages of the two alternative approaches mentioned above (taking into account non-EU activities versus taking into account only EU activities of a group)? Please provide reasons for your answer.

With regard to the geographical scope of ancillary activities:

- It is necessary to distinguish between the definition of group and the geographical scope for "ancillary activities at a group level" in commodity derivatives: only ancillary activities conducted within the EU area are to be considered as "ancillary activities at a group level". MiFID II can only regulate (and exempt) those activities which are subject to its jurisdiction, i.e., activities within the EU area. Hence, the relevant ancillary activities are only those which have a link to the EU, i.e., involve an EU counterparty or/and executed over an EU trading venue/CCP.

- MiFID II has – contrary to EMIR – no explicit rules urging its extra-territorial application. To extend the application scope of EU legislation, i.e., to require that a group firm which is exclusively active in a non-EU jurisdiction becomes subject to MiFID II regulations, has the potential for conflicting and double regulation if this firm is subject to the supervision of the competent authority of that non-EU jurisdiction. For example, applying the ancillary activity test also to activities of such non-EU companies would force firms to consider under MiFID II certain products, e.g., EUA allowances, as financial instruments, while the same products are not financial instruments under 3rd country jurisdiction, e.g., as is the case for EUA allowances in the U.S.. Hence, the difficulty of applying a global understanding of ancillary activities at a group level is the consequential extraterritorial application of MiFID II. Also, double regulation in different jurisdictions is an added complexity to both the firm and the regulator. For example, the measurement of the overall global trading activities is difficult for firms because the available data is not always comparable in the different jurisdictions, because there is no appropriate trade data available in some jurisdictions or the available trade data differs substantially from each other. For these reasons, a consideration of ancillary activities outside of the EU area also conflicts with the principle of proportionality underlying MiFID II.

- A further possible disadvantage of the world-wide approach in respect to the ancillary activity is the difficulty to assess the overall world-wide market size of the trading activity due to the lack of available transactional data and different regional definition, e.g. of a commodity derivative. Should transactional data be available the different transaction reporting regimes would most likely lead to a different set of data content.

Concerning the definition of a group with regard to the geographical scope of the main business at group level:

• It is not clear if the hedging exemption in relation to commercial activities would also be applied on an EU basis only (ESMA DP, page 394, no. 21), if the definition of group were to mean the EU group only. This would be a significant problem for firms operating global commercial operations such as exploration, which need to hedge their commercial risks on a global basis through a trading entity which is established in the EU. In favour of a worldwide approach to the commercial activities speaks also that ESMA proposes that the hedging definition of EMIR should apply to the privileged risk reducing transactions under Art. 2(4)(c) of MiFID II and EMIR does not limit the geographical scope of the relevant underlying commercial business to EU business. Consequently, also non-EU activities should be part of the main business on a group basis provided that these activities are related to hedging activities in the EU.

With regard to the scope of the ancillary activity test:

• The test in Article 2(1)(j) of MiFID II and the licensing requirement in Art. 5 in conjunction with Art. 2(1) no 1 of MiFID II applies to persons and not to an entire group, such persons being 'understood as including both natural and legal persons' (see Recital 26 of MiFID II). Hence, in case the group fails the ancillary activity test it should be sufficient that a person, i.e., a firm within the group and not the entire group, can become subject to MiFID II and apply for a MiFID II license, provided that the remaining firms within the same group meet the criteria of the ancillary activities exemption.

• The activities performed by a MiFID II regulated entity (within a non-financial corporate group) are not to be considered when defining and calculating the ancillary activities, i.e., the business of a MiFID licensed firm has not to be taken into account in the ancillary activity test. The ancillary activities exemption aims at exempting those firms/groups whose primary business is not rendering investment service within the scope of MiFID II. In this regard, MiFID II has voted for a "group basis approach" to assess if the trading activities are ancillary to the main business of the group. Hence, the business of the group of companies as a whole has to be assessed and not only on the basis of the nature or activity of a single (regulated) entity. This means that the ancillary activity exemption applies if the commercial activity is the dominant "main business" of a non-financial corporate group and the main business is not the provision of investment services or banking activities. Therefore, it would give a wrong picture of the characteristics of a group's business if the MiFID II regulated entity within a group were able to determine with regard to all other group companies which business such group primarily conducts if overall the commercial activity is the dominant main business. In other words, it should be possible for non-financial groups that do not meet the ancillary activity test, to set up separated investment firms to avoid that all other group entities would need an investment firm license. This would also be in line with the approach of MiFID II that the MiFID II licensing regime applies to a person and not to a group. Most importantly, this outcome would not contradict or conflict with the purposes pursued by MiFID II, since the business of the non-considered entity, i.e., the MiFID II licensed investment firm, would remain subject to all regulatory requirements under MiFID II. Such approach would finally also be coherent with the approach under Article 10(3) EMIR: According to Article 10(3) EMIR, when calculating the clearing threshold, a non-financial counterparty only considers the OTC contracts entered into by itself and by other non-financial entities within its group (as opposed to financial counterparties). Also the provisions of Recital 38 and Articles 2, 3 and 4 of EMIR prove that the simultaneous presence of financial and non-financial counterparties within a group does not mean automatically that the entire group and all its entities are financial entities.

With regard to taking into account emission allowances in the calculation of a firm's trading activity:

- EFET would like to ask ESMA that emission allowance trading activities exempted under Article 2(1)(e) of MiFID II shall not to be considered as ancillary activities for the purposes of Article 2(1)(j) of MiFID II. This approach can be supported with the argument that a different view would make those activities subject to a second MiFID II test under Article 2(1)(j) of MiFID II and disregard the lex specialis character of Article 2(1)(e) of MiFID II. Hence, EFET believes that emission allowance dealing activities exempted under Article 2(1)(e) of MiFID II should not be considered when assessing the ancillary activities.

Concerning the legal consequences of a threshold breach:

- EFET believes that the issue of whether a breach in one asset class will trigger the obligation for a licence under MiFID II in respect of the commodity asset class in which a breach is acknowledged and/or in respect of all commodity derivatives should be left to national supervisory practice (under guidance of ESMA). In EFET's opinion a breach in a commodity asset class should only trigger MiFID II requirements for this asset class (see our response to Q478).

Q466: What are the main challenges in relation to both approaches and how could they be addressed?

With regard to the geographical scope of ancillary activities:

- It is necessary to distinguish between the definition of group and the geographical scope for "ancillary activities at a group level" in commodity derivatives: only ancillary activities conducted within the EU area are to be considered as “ancillary activities at a group level”. MiFID II can only regulate (and exempt) those activities which are subject to its jurisdiction, i.e., activities within the EU area. Hence, the relevant ancillary activities are only those which have a link to the EU, i.e., involve an EU counterparty or/and executed over an EU trading venue/CCP.

- MiFID II has – contrary to EMIR – no explicit rules urging its extra-territorial application. To extend the application scope of EU legislation, i.e., to require that a group firm which is exclusively active in a non-EU jurisdiction becomes subject to MiFID II regulations, has the potential for conflicting and double regulation if this firm is subject to the supervision of the competent authority of that non-EU jurisdiction. For example, applying the ancillary activity test also to activities of such non-EU companies would force firms to consider under MiFID II certain products, e.g., EUA allowances, as financial instruments, while the same products are not financial instruments under 3rd country jurisdiction, e.g., as is the case for EUA allowances in the U.S.. Hence, the difficulty of applying a global understanding of ancillary activities at a group level is the consequential extraterritorial application of MiFID II. Also, double regulation in different jurisdictions is an added complexity to both the firm and the regulator. For example, the measurement of the overall global trading activities is difficult for firms because the available data is not always comparable in the different jurisdictions, because there is no appropriate trade data available in some jurisdictions or the available trade data differs substantially from each other. For these reasons, a consideration of ancillary activities outside of the EU area also conflicts with the principle of proportionality underlying MiFID II.

- A further possible disadvantage of the world-wide approach in respect to the ancillary activity is the difficulty to assess the overall world-wide market size of the trading activity due to the lack of available transactional data and different regional definition, e.g. of a commodity derivative. Should transactional data be available the different transaction reporting regimes would most likely lead to a different set of data content.

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- The activities performed by a MiFID II regulated entity (within a non-financial corporate group) are not to be considered when defining and calculating the ancillary activities, i.e., the business of a MiFID licensed firm has not to be taken into account in the ancillary activity test. The ancillary activities exemption aims at exempting those firms/groups whose primary business is not rendering investment service within the scope of MiFID II. In this regard, MiFID II has voted for a "group basis approach" to assess if the trading activities are ancillary to the main business of the group. Hence, the business of the group of companies as a whole has to be assessed and not only on the basis of the nature or activity of a single (regulated) entity. This means that the ancillary activity exemption applies if the commercial activity is the dominant "main business" of a non-financial corporate group and the main business is not the provision of investment services or banking activities. Therefore, it would give a wrong picture of the characteristics of a group's business if the MiFID II regulated entity within a group were able to determine with regard to all other group companies which business such group primarily conducts if overall the commercial activity is the dominant main business. In other words, it should be possible for non-financial groups that do not meet the ancillary activity test, to set up separated investment firms to avoid that all other group entities would need an investment firm license. This would also be in line with the approach of MiFID II that the MiFID II licensing regime applies to a person and not to a group. Most importantly, this outcome would not contradict or conflict with the purposes pursued by MiFID II, since the business of the non-considered entity, i.e., the MiFID II licensed investment firm, would remain subject to all regulatory requirements under MiFID II. Such approach would finally also be coherent with the approach under Article 10(3) EMIR: According to Article 10(3) EMIR, when calculating the clearing threshold, a non-financial counterparty only considers the OTC contracts entered into by itself and by other non-financial entities within its group (as opposed to financial counterparties). Also the provisions of Recital 38 and Articles 2, 3 and 4 of EMIR prove that the simultaneous presence of financial and non-financial counterparties within a group does not mean automatically that the entire group and all its entities are financial entities.

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• EFET believes that the issue of whether a breach in one asset class will trigger the obligation for a licence under MiFID II in respect of the commodity asset class in which a breach is acknowledged and/or in respect of all commodity derivatives should be left to national supervisory practice (under guidance of ESMA). In EFET's opinion a breach in a commodity asset class should only trigger MiFID II requirements for this asset class (see our response to Q478).

Q467: Do you consider there are any difficulties concerning the suggested approach for assessing whether the ancillary activities constitute a minority of activities at group level? Do you consider that the proposed calculations appropriately factor in activity which is subject to the permitted exemptions under Article 2(4) MiFID II? If no, please explain why and provide an alternative proposal.

EFET does not agree with some parts of ESMA's proposed formula for assessing whether an ancillary activity constitutes a minority of activity at group level as set out on pages 395 and pages 396 of the ESMA discussion paper, as it would lead to inappropriate outcomes, which contradict the aim of privileging companies which trade financial instruments for hedging purposes and/or provide liquidity on trading venues as well as companies which have group-internal risk management systems via intra-group trading of derivatives.

ESMA subtracts the capital employed for the privileged transactions (intra-group transactions, hedging transactions and transactions entered into fulfil obligations to provide liquidity) from trading activities in commodity derivatives (ancillary activity) as well as from the overall main business at group level. This approach is problematic as privileged transactions are part of a group's main business, such as risk management activities, and as this approach can prevent a firm from taking advantage of the ancillary activity exemption although it uses its capital only for one or more of the privileged activities. We believe the words "The elements referred to in the second and third subparagraphs…" of Article 2(4) of MiFID II are intended to exclude capital used for a) intragroup transactions, b) transactions reducing commercial or treasury financing risks, and c) transactions fulfilling obligations to provide liquidity, only from counting towards the capital used for conducting ancillary activities in commodity derivatives. This view is supported by Recital 20 of MiFID II which states that "... where the obligation to provide liquidity on a venue is required by regulatory authorities in accordance with Union or national laws.... the transactions entered into to meet such an obligation should be excluded in the assessment of whether the activity is ancillary."

In this context EFET would like to clarify that EFET agrees with ESMA's approach that the privileged transactions are deducted from

- the capital employed for the overall trading activities of a group (ESMA CP, pages 395 and 396) and
- the volume of a the group's overall trading activity in commodity derivatives, emission allowances and emission allowance derivatives (pages 397 and 398).

Q468: Are there other approaches for assessing whether the ancillary activities constitute a minority of activities at group level that you would like to suggest? Please provide details and reasons.

EFET supports the approach used to assess the 'size of trading activity' as provided on pages 397 and pages 398 of the ESMA discussion paper since the rationale and exemptions are the same.

Q469: How should "minority of activities" be defined? Should minority be less than 50% or less (50 - x)%? Please provide reasons.

EFET agrees that any activity which constitutes less than 50% of the main activity of the group should be understood to be a minority of the group´s activities. EFET does not believe that minority should be less than 50%.

Q470: Do you have a view on whether economic or accounting capital should be used in order to define the elements triggering the exemption from authorisation under MiFID II, available under Article 2(1)(j)? Please provide reasons.

EFET believes that accounting capital can be used to determine the ancillary activity definition. EFET understands accounting capital to mean capital employed by a firm which is calculated from its balance sheet or financial measures. Using accounting capital as the measurement for the MiFID II ancillary activities exemption would enable a consistent application of the rules across all market participants given that company balance sheets and financial figures are independently audited on a yearly basis (mainly relying on IFRS or equivalent principles) and are publically available. This approach will allow firms to use figures that they already calculate and avoid the additional compliance burden to perform additional, new calculations. However, it may be difficult to assign capital under accounting capital measures to the different activities, i.e., ancillary activities, group main business and the "privileged transactions" (intra-group transactions, hedging transactions and transactions entered into fulfil obligation to provide liquidity), in particular if the group does not have a dedicated subsidiary for undertaking activities in respect of commodity derivatives. Therefore, EFET recognises the need to identify, and EFET is open to a discussion on proxies to determine the respective capital employed amount of the different activities and to enable firms to calculate the figures in a consistent manner.

In contrast economic capital is not a defined term, not subject to international, generally accepted conventions and it is not applied in a harmonised manner by firms. An economic capital approach typically uses a variety of internal stress test methodology in its calculation and tends to be based on differing proprietary risk evaluation models. Depending on the methodology chosen, it has the benefit that it can be set in advance and therefore nullify the risks of being caught by the calculations ex-post. Overall, EFET believes that using economic capital would need substantial future efforts in terms of convention and harmonisation to define and calculate economic capital, e.g., through ESMA guidelines. Otherwise, using economic capital as a measure would not provide regulators with a consistent result across all commodity market participants and expose firms to substantial uncertainties about their status under MiFID II.

For these reasons of simplicity and availability of definitions, EFET has a preference to use an accounting capital measurement unless the harmonisation effort for an alternative economic capital measure can be realised by ESMA.

Q471: If economic capital were to be used as a measure, what do you understand to be encompassed by this term?

If economic capital were to be used as a measure, EFET believes that ESMA would have to define (through guidelines) how to calculate economic capital, as such a calculation is neither legally defined nor harmonised. Currently an economic capital calculation typically uses a variety of stress test methodology and is based on differing proprietary risk assessment models. Furthermore, it should not be too complex and economic capital should adequately reflect the capital employed.

Q472: Do you agree with the above assessment that the data available in the TRs will enable entities to perform the necessary calculations?

EFET does believe that Trade Repositories (TRs) can only deliver the data to assess the overall trading activity in commodity derivatives, emission allowances and emission allowances derivatives under the following pre-conditions:

1. The geographical scope of ancillary activities on a group level covers the EU exclusively.

2. Firms are best placed to assess their overall trading activity and reconcile their ancillary activities data and only alternatively should they be required/able to use the TRs to assess their own ancillary activities in commodity derivatives. However, it would be helpful to standardize the calculations, i.e., if there where ESMA Guidelines on the calculation or if the TRs could offer standardized data for all.

3. TRs need to cooperate and publish (freely available on non-commercial basis) reasonable numbers on the 'size of the market' in notional value. The data should be published in an aggregated manner for the whole EU market and the relevant commodity asset classes.

4. Firms have to be able to obtain from TRs the data they need to perform calculations in relation to their own trading activity and on the overall trading activity, including information about privileged transactions. Again, it would be helpful if TRs could offer standardized data.

5. There needs to be a clear and harmonised methodology to calculate the overall size of the market based on notional value in a certain period (sum of the notional value across commodity asset classes). In addition regulators need to be clear on what type of information they need to determine overall trading activity and for what purpose

6. Given that only EU entities are subject to reporting derivative trades to a TR under EMIR, a large part of the market which is traded by non EU entities bi-laterally or on markets external to the EU would not be reportable. Therefore, there would be no way of incorporating these non-EU transactions into the overall market trading activity data held in European TRs. A global effort to harmonise the transactions reporting regime in the different jurisdictions would be necessary, but already today these reporting regimes differ a lot or are still missing.

7. Overall, TRs need to be reliable, robust and provide consistent information.

Q473: What difficulties do you consider entities may encounter in obtaining the information that is necessary to define the size of their own trading activity and the size of the overall market trading activity from TRs? How could the identified difficulties be addressed?

If the geographical scope of ancillary activities on a group level also covers non-EU activities, TRs of 3rd countries (if any) could not provide a picture of overall non-EU market activities for many reasons:

1. The trade reporting regime and its scope is different in non-EU jurisdictions.

2. The definition of reportable commodity derivatives is different in non-EU jurisdictions.

3. TRs only exist in a certain number of non-EU jurisdictions, so that the available TR data does not reflect the entire global overall market size.

Independently of issues related to the geographical scope EFET would like to highlight the following problems:

1. EFET considers difficulties with regard to legal certainty about the size of the overall market. A competent authority / entity, e.g., TRs, should publish the overall market size for the EU in a standardized manner (freely available on non-commercial basis).

2. The overall market size should not fluctuate and therefore should be officially announced and kept stable for at least a year.

3. The method must be transparent.

4. Firms should not be obliged to calculate the size of their trading activities more often than on a yearly average basis.

Q474: What do you consider to be the difficulties in defining the volume of the transactions entered into to fulfil liquidity obligations?

EFET would like to highlight the following problems:

1. Currently, firms do not specifically identify the volume of transactions that serve for liquidity obligations separately from other transactions and therefore they will have to develop systems to captures these activities.

2. In the UK the volume of transactions entered into to fulfil mandatory liquidity obligations is recorded in quarterly submissions which have to be made by the six largest vertically integrated companies to the regulator, Ofgem (see under: https://www.ofgem.gov.uk/publications-and-updates/wholesale-power-market-liquidity-decision-letter). Therefore, firms can measure it only based on their quarterly reporting obligation.

Q475: How should the volume of the overall trading activity of the firm at group level and the volume of the transactions entered into in order to hedge physical activities be measured? (Number of contracts or nominal value? Period of time to be considered?)

EFET supports the measuring of overall trading activity at group level to be additions of the nominal values of each contract held by the entire group (gross notional value).

It should discount the privileged transactions from the overall trading activity. It needs to be measured using the same methodology for measuring the overall market activity.

Q476: Do you agree with the level of granularity of asset classes suggested in order to provide for relative comparison between market participants?

EFET agrees that a single overall commodity asset class does not seem as acceptable given that Article 2(4), paragraph 2 of MiFID II speaks of commodity asset classes and not of commodity derivatives. However, EFET is of the opinion that single commodities should be aggregated in ‘natural markets’. Therefore, like for metals, the energy commodity classes should be grouped in one single asset class called “Energy Commodities” including oil, coal, gas, power and emissions, also because they are correlated with each other.

Q477: What difficulties could there be regarding the aggregation of TR data in order to obtain information on the size of the overall market trading activity? How could these difficulties be addressed?

EFET does believe that Trade Repositories (TRs) can only deliver the data to assess the overall trading activity in commodity derivatives, emission allowances and emission allowances derivatives under the following pre-conditions:

1. The geographical scope of ancillary activities on a group level covers the EU exclusively.

2. Firms are best placed to assess their overall trading activity and reconcile their ancillary activities data and only alternatively should they be required/able to use the TRs to assess their own ancillary activities in commodity derivatives. However, it would be helpful to standardize the calculations, i.e., if there where ESMA Guidelines on the calculation or if the TRs could offer standardized data for all.

3. TRs need to cooperate and publish (freely available on non-commercial basis) reasonable numbers on the ‘size of the market’ in notional value. The data should be published in an aggregated manner for the whole EU market and the relevant commodity asset classes.

4. Firms have to be able to obtain from TRs the data they need to perform calculations in relation to their own trading activity and on the overall trading activity, including information about privileged transactions. Again, it would be helpful if TRs could offer standardized data.

5. There needs to be a clear and harmonised methodology to calculate the overall size of the market based on notional value in a certain period (sum of the notional value across commodity asset classes). In addition regulators need to be clear on what type of information they need to determine overall trading activity and for what purpose

6. Given that only EU entities are subject to reporting derivative trades to a TR under EMIR, a large part of the market which is traded by non EU entities bi-laterally or on markets external to the EU would not be reportable. Therefore, there would be no way of incorporating these non-EU transactions into the overall market trading activity data held in European TRs. A global effort to harmonise the transactions reporting regime in the different jurisdictions would be necessary, but already today these reporting regimes differ a lot or are still missing.

7. Overall, TRs need to be reliable, robust and provide consistent information.

If the geographical scope of ancillary activities on a group level also covers non-EU activities, TRs of 3rd countries (if any) could not provide a picture of overall non-EU market activities for many reasons:

1. The trade reporting regime and its scope is different in non-EU jurisdictions.

2. The definition of reportable commodity derivatives is different in non-EU jurisdictions.

3. TRs only exist in a certain number of non-EU jurisdictions, so that the available TR data does not reflect the entire global overall market size.

Independently of issues related to the geographical scope EFET would like to highlight the following problems:

1. EFET considers difficulties with regard to legal certainty about the size of the overall market. A competent authority / entity, e.g., TRs, should publish the overall market size for the EU in a standardized manner (freely available on non-commercial basis).

2. The overall market size should not fluctuate and therefore should be officially announced and kept stable for at least a year.

3. The method must be transparent.

4. Firms should not be obliged to calculate the size of their trading activities more often than on a yearly average basis.

Q478: How should ESMA set the threshold above which persons fall within MiFID II's scope? At what percentage should the threshold be set? Please provide reasons for your response.

A) EFET agrees with ESMA that the threshold test pursuant to Article 2(4), paragraph 2 and 3 of MiFID II consists of the following two relative threshold tests:

(1) The capital employed for dealing on own account (minus the capital employed for privileged transactions), the capital for the provision of other investment services

to customers or suppliers (both hereinafter the “trading activities”) and the sum of these two trading activities must account for less than maximum 50% of the capital employed for the main business at group level (ESMA DP, page 395, no. 25).

(2) The size of a firm’s trading activity (minus privileged transactions) must account for less than “a still to-be-defined share” of the overall market trading activity in “a still to-be-defined” commodity asset class (hereinafter the “trading activities test”) (ESMA DP, pages 397 et seq.).

In EFET’s opinion these two relative threshold tests shall be applied cumulatively, i.e. a firm is exempted under the ancillary activity exemption if it stays below these two thresholds, respectively, a firm is not exempted if it breaches both thresholds. This understanding is supported by the clear wording of Article 2 (4), paragraph 2 of MiFID II that ESMA shall take account of the two relative threshold tests when defining the criteria for ancillary activities (“Those criteria shall take into account at least the following elements:”).

EFET is of the opinion that the thresholds for the trading activities test can only be set based on robust and reliable data of the overall market trading activities. Such data is available as from the date of application of the MiFID II, i.e., 3 January 2017 and not before. In addition, the scope of ancillary activity and the available data depends very much on the MiFID II implementation (measures), e.g., definitions of commodity derivatives and market infrastructure (i.e., further definition of MTFs and OTFs).

For these reasons, EFET believes that for an initial period of 3 years as from 3 January 2017 these thresholds should be set at a higher level (e.g., of 50%). Such an approach is required to avoid unintended consequences and adverse impacts on the competitiveness and liquidity of the EU energy markets, e.g., setting the thresholds at a too low level could force firms to leave the market or reduce their trading activities to avoid a MiFID II regime. Also the interplay of the thresholds for the ancillary activity test with other quantitative test/limits, e.g., the clearing threshold test under EMIR and the position limits under MiFID II, can only be fully understood once the MiFID II data is available. After the application of MiFID II as from 3 January 2017 the MiFID II data will be available and then the level of thresholds can be reviewed and set, following consultation with relevant stakeholders, on the basis of robust and reliable data once the initial time period of 3 years expired.

B) With regard to the methodology of the thresholds for the trading activities test EFET is of the opinion that the following principles are relevant:

- As explained in the response of EFET to Q466, the relevant geographical market for the overall trading activities is the EU, as trade repository data only for this region will be available in a robust and reliable manner.

- EFET is of the opinion that a breach of a threshold for the trading activity test in one commodity asset class triggers exclusively the MiFID II licensing requirements for this single commodity asset class. Therefore, EFET does not agree with ESMA that a breach in one single commodity asset class triggers the MiFID II licensing requirements for all other commodity asset classes in which a firm trades (ESMA DP, page 399, no. 37). This analogy to EMIR (whereby when a non-financial firm passes the clearing threshold set for one asset class, it is subject to the clearing obligation for all asset classes) is not possible:

o At first MiFID II does not explicitly provide in its Article 2(4), paragraph 2 and 3 for such a mechanism (and this is in contrast to EMIR, which explicitly provides in its Article 10(1)(c) that non-financial firms shall "clear all relevant future contracts within four months of becoming subject to the clearing obligation"). On the contrary, the wording of the MiFID II provision ("the size of their trading activity compared to the overall market trading activity in that asset class") points rather to a single asset class consideration.

o Secondly, the usual legal preconditions for such an analogous application are not met: The underlying regulatory aims and methodologies of MiFID II and EMIR are substantially different and therefore such an analogy to the disadvantage of the concerned firms is legally not permitted.

• The thresholds have to be set in consideration of the overall market size and, hence, of the trading activities of all market participants, as the wording of Article 2(4), paragraph 2, lit. (b) of MiFID II explicitly refers to such an overall market approach ("the size of their trading activity compared to the overall market trading activity in that asset class"). Therefore, EFET does not agree with ESMA that these thresholds should be set in comparison to the trading activities of MiFID II authorised firms (ESMA DP, page 401, no. 48) as this approach would only reflect a sub-set, and not necessarily relevant sub-set, of the market. It is also not the underlying purpose of Article 2(1)(j) and 2(4), paragraph 2, lit. (b) of MiFID II that the usage of the ancillary activity exemption shall depend on the level of activity of authorised firms. Otherwise, this exemption would become meaningless for non-financial firms if authorised firms exit the market or substantially reduce their activities.

• EFET does not agree with the statement by ESMA that – based on Recital 20, paragraph 2 – it would like to set a threshold at a relatively low level (ESMA DP, page 401, no. 48). ESMA cannot base such an approach on the wording of Recital 20, paragraph 2 ("Those criteria should ensure that non-financial firms dealing in financial instruments in a disproportionate manner compared with the level of investment in the main business are covered by the scope of this Directive. In doing so, those criteria should take at least into consideration, the need for ancillary activities to constitute a minority of activities at group level and the size of their trading activity compared to the overall market trading activity in that asset class."). This Recital wording does not urge the setting of thresholds for the trading activities at a lower level.

• MiFID II aims at mitigating systemic risk and, therefore, EFET believes that a criteria to be considered when setting the thresholds is the systemic relevance of non-financial firms' trading activities, although EFET agrees that appropriate consultations should take place to identify what 'systemic' encompasses. For this purpose ESMA could use the work of the FSB (Financial Stability Board) with regard to the definition of the group of global systemically important banks (G-SIBs) (see under: http://www.financialstabilityboard.org/publications/r_131111.pdf)

C) With regard to the concrete percentage at which the thresholds for the trading activities test should be set, EFET would like to make the following observations:

EFET is not able to have a view on exact threshold percentages as EFET believes these can only be sensibly assessed once all data on transactions and positions under MiFID II is available. In order for EFET to make an assessment regarding any type of threshold, EFET would need further clarification from ESMA on the following fundamental points:

- What is ESMA's definition of commodity market?
- What is ESMA's definition of commodity market size?
- How does ESMA intend to measure market size (metrics and methodology)?

In addition EFET would need significantly more information as to how thresholds will work according to asset class. For example, a percentage of a large asset class would have to be set at a potentially low level and a threshold for a much smaller asset class would have to be set at a potentially higher level to allow for the difference in volumes traded in each asset class.

Q479: Are there other approaches for determining the size of the trading activity that you would like to suggest?

No.

Q480: Are there other elements apart from the need for ancillary activities to constitute a minority of activities and the comparison between the size of the trading activity and size of the overall market trading activity that ESMA should take into account when defining whether an activity is ancillary to the main business?

No. EFET believes that additional quantitative or qualitative tests would only add more complexity and implementation burdens / costs without creating legal clarity and any obvious benefits for firms, financial regulators and the commodity / energy markets.

Q481: Do you see any difficulties with the interpretation of the hedging exemptions mentioned above under Article 2(4)(a) and (c) of MiFID II? How could potential difficulties be addressed?

As regards Article 2(4)(a) of MiFID II, EFET agrees that the use of Article 3 of EMIR for defining the exemption of intragroup transactions from the ancillary threshold is appropriate.

EFET agrees with the ESMA statement regarding the privileged transactions under Article 2(4)(c) of MiFID II, i.e., transactions in commodity derivatives, emission allowances and emission allowance derivatives entered into to fulfil obligations to provide liquidity on a trading venue shall not be taken into account, where such obligations are required by regulatory authorities in accordance with EU or national laws, regulations and administrative provisions or by trading venues. In particular, EFET agrees that obligations to provide liquidity could be established by rules of trading venues.

Q482: Do you agree with ESMA's proposal to take into account Article 10 of the Commission Delegated Regulation (EU) No 149/2013 supplementing EMIR in specifying the application of the hedging exemption under Article 2(4)(b) of MiFID II? How could any potential difficulties be addressed?

Yes. Such a uniform approach would reduce the administrative burdens of the firms concerned and is hence supported by the principle of proportionality underlying MiFID II. In particular, recital 21 to MiFID II explicitly states that "for the purposes of this Directive and of Regulation (EU) No 600/2014, which regulate both OTC and exchange-traded derivatives within the meaning of Regulation (EU) No 600/2014, activities that are deemed to be objectively measurable as reducing risks directly relating to the commercial activity or treasury financing activity and intragroup transactions should be considered in a consistent way with Regulation (EU) No 648/2012." Finally, there is no need to apply a deviating standard in the context of MiFID II. It is irrelevant in this regard that (for reason of the limitation of the EMIR RTS legal framework) Article 10 of the EMIR RTS, other than Article 2(4) of MiFID II, is restricted to OTC derivative contracts.

However, it is necessary to clarify that the scope of the hedging exemption under Article 2(4)(b) covers all derivatives and is not limited only to OTC derivatives. Therefore, EFET suggests that full reference to the relevant definition of the hedging exemption as defined in EMIR and the EMIR RTS is made together with a clarification that this definition is valid for all derivatives.

Q483: Do you agree that the obligations to provide liquidity under Article 17(3) and Article 57(8)(d) of MiFID II should not be taken into account as an

obligation triggering the hedging exemption mentioned above under Article 2(4)(c)?

No, EFET does not agree. If a firm is required by a trading venue to provide liquidity back to the market under Article 57(8)(d) of MiFID II it should be allowed to apply the hedging exemption under Article 2(4)(c) of MiFID II as it would not be able to control the direction and size of trading it would be required to undertake.

The same applies to the obligation to provide liquidity under Article 17(3) of MiFID II.

Furthermore, EFET disagrees with ESMA that firms subject to these obligations are per se excluded from the ancillary activity exemption as only firms which apply a high-frequency algorithmic trading technique are excluded from taking advantage of the ancillary activity exemption.

Q484: Could you provide any other specific examples of obligations of “transactions in commodity derivatives and emission allowances entered into to fulfil obligations to provide liquidity on a trading venue” which ESMA should take into account?

As mentioned above in the response to Q481 EFET agrees that obligations to provide liquidity could be established by rules of trading venues. Today such obligations are contained in the usual market making agreements between energy firms and energy exchanges.

Q485: Should the (timeframe for) assessment be linked to audit processes?

Yes, EFET does believe that the timeframe for the assessment process should be linked to regular annual audits, provided there is a well-defined accounting measure. This would be in line with the requirement that firms have to notify annually their financial regulator that they make use of the ancillary activity exemption. EFET agrees with ESMA that a daily or monthly calculation is not appropriate as firms’ trading activities and the overall market trading activity may fluctuate over the year, so that an annual test on an average basis would avoid that firms “fall in and out” of MiFID II regulation due to seasonal patterns of activity.

With regard to the implicit question whether the solution can be to have a mandatory external annual audit on whether the requirements of the ancillary activity exemption are fulfilled, i.e., if a firm meets the capital employed and the trading activities test, EFET would like to make ESMA aware that market participants are sceptical based on the following comments: While the current audit process would verify the reported numbers in the person's balance sheet and income statement, it does not currently verify what proportion of that person's capital is employed specifically for dealing on own account or providing investment services and what are exactly the trading activities of a firm / group in commodity derivatives, emission allowances and emission allowance derivatives, unless those are the person's only activities. In practice this means that an additional and new audit process and audit content have to be set up which are fit for purpose. More importantly, Article 2(1)(j) of MiFID II requires that firms have only to report to their financial regulator upon request the basis on which they consider that their activity is exempted and this speaks rather against a regular, general auditing obligation for all firms. Therefore, EFET believes that an audit report should (if at all) be provided by the concerned firm only upon the justified request from a financial regulator, but that firms can report their figures about their capital employed and trading activities independently of such audit report. Alternatively, one could consider if such an audit process could be integrated into eventually already existing – in certain Member States – audit process under EMIR (see Germany), which, however, would only mitigate to some degree the efforts and costs incurred by firms.

Q486: How should seasonal variations be taken into account (for instance, if a firm puts on a maximum position at one point in the year and sells that down through the following twelve months should the calculation be taken at the maximum point or on average)?

EFET strongly recommends the calculation to be taken on an average basis at points throughout a twelve month period. This approach would give a more accurate result as it would avoid distortion from any sharp seasonally-related volatility spikes.

Q487: Which approach would be practical in relation to firms that may fall within the scope of MiFID in one year but qualify for exemption in another year?

EFET believes that firms should be assessed on a 3 year rolling average of their trading activity reported to regulators on an annual basis. EFET believes that trading activity data should be based on continual assessment throughout 12 months of the year and not based on a single snapshot at a given point in time.

If a firm falls into MiFID II on this basis then a minimum 12 month transition period should be given to enable the firm to take the necessary operational steps to implement MiFID II requirements or be allowed reduce its ancillary activity down to a level below the to be defined thresholds.

Q488: Do you see difficulties with regard to the two approaches suggested above?

As mentioned in the responses to Q487 and Q488 EFET agrees with ESMA that firms should be assessed on a 3 year rolling average of their trading activity on an annual basis and that this annual calculation takes place on an average basis at points throughout a twelve month period.

The problem EFET sees is the implementation challenge for a firm who breaches the thresholds and consequently would become subject to a MiFID II licensing regime. For a non-financial firm this would trigger a very important, costly and substantial reorganisation and new compliance obligations, in particular in terms of organisational and commercial structure, implementation of new MiFID II compliance obligations for investment firms (e.g., the platform trading obligation) and application of a vast number of additional regulatory requirements under other financial legislation (e.g., central clearing under EMIR, capital requirements under CRD IV). Also, the MiFID II licensing proceedings and their preparation usually take at least a year until a licence is granted by a financial regulator. Given these implementation challenges for a firm to become a MiFID II investment firm we believe that a minimum transition period of 12 months is required for a firm to be deemed to be a MIFID II firm.

Q489: How could a possible interim approach be defined with regard to the suggestion mentioned above (i.e. annual notification but calculation on a three years rolling basis)?

EFET proposes the following approach for the starting dates of the calculation on a three years rolling basis:

1. Firms could start collecting data under MiFID II as from 3 January 2017.

2. The first annual calculation period would be finished by 3 January 2018 and firms would have to notify by 3 January 2018 their national financial regulator that they use the ancillary activity exemption.

This approach is based on the following reasoning:

- In the opinion of EFET the calculation period of 3 years can only start when the Level 1 legislation of MiFID II applies as from 3 January 2017 as this legal framework is the legal basis for the ancillary activities exemption, for the RTS to define ancillary activities, for the Delegated Acts to define commodity derivatives and for the firms to assess whether they are in or out of scope.

- MiFID I is still applicable until the application of MiFID II and therefore firms must be able to rely in good faith on the current own account exemption pursuant of Article 2(1)(k) of MiFID I. Otherwise, MiFID II and its implementing measure would apply retro-actively which is not permitted in such cases.

- Before the legal application of the MiFID II framework and its implementing measures (RTS, ITS and Delegated Acts) and its transposition into national law, there is no legal certainty and clarity about the scope of MiFID II, in particular in terms of exemptions and definition of financial instruments and definition of market places (MTFs and OTFs).

- The only relevant data for the calculation is the data available under the applicable MiFID II regime and not any MiFID I data (as the scope and content of MiFID I and II differ substantially, in particular in respect of the definition of commodity derivatives). This MiFID II data would start to be available in January 2017 and not before. Consequently, any data collection and calculation cannot start earlier.

- For these reasons firms cannot be obliged to start the calculation at an earlier stage than January 2017.

Q490: Do you agree that the competent authority to which the notification has to be made should be the one of the place of incorporation?

Yes. EFET agrees that only the competent authority in the place of incorporation of the entity invoking the (j) exemption should be notified and is the only competent authority for that firm. This is consistent with regulatory supervisory regimes already in place at a national level throughout the EU and would avoid potential conflicts, double regulation and inconsistencies if several financial regulators would be competent authorities.

7.2. Position Limits

Q491: Do you agree with ESMA's proposal to link the definition of a risk-reducing trade under MiFID II to the definition applicable under EMIR? If you do not agree, what alternative definition do you believe is appropriate?

EFET agrees that the definition of risk reducing trades under MiFID II should be the same as under EMIR, i.e. article 10(3) of EMIR and article 10 of the EMIR regulatory technical standards (EU N° 149/2013) and clarifications given in Question OTC 10 of ESMA's FAQ (last update published on 10 July 2014), with the exception of treasury financing activities that are not covered by article 57 of MiFID II.

However, this should be enlarged also to commodity derivatives traded on regulated platforms, since the definition provided in EMIR is referred to OTC derivatives only.

Q492: Do you agree with ESMA's proposed definition of a non-financial entity? If you do not agree, what alternative definition do you believe is appropriate?

EFET agrees that the definition of non-financial entity (NFE) under the MiFID II position limits regime should be aligned with the definition of non-financial counterparty (NFC) under article 2(9) of EMIR, which excludes entities which must obtain licence under existing European financial services legislation as set out in the definition of 'financial counterparty' under article 2(8) of EMIR (i.e. investment firms, credit institutions, insurance companies, UCITS and their asset management companies, AIFs and their management companies, pension funds).

However, EFET notes with concern ESMA's proposal in paragraph 14 that MiFID II would use the existing comparable definition within EMIR of non-financial counterparty. The definition of NFE does not currently appear to consider application to third country entities. A third country credit institution with no presence in the EU will not be required to seek authorisation under the Banking Directive, and so under the current definition would qualify as a NFE. For the purpose of alignment with the EMIR NFC concept, the definition should be amended to cover entities established in the EU which are not required to seek authorisation under the relevant directives, and entities established outside the EU which would not have been required to seek authorization if they had been established in the EU.

Q493: Should the regime for subsidiaries of a person other than entities that are wholly owned look to aggregate on the basis of a discrete percentage threshold or on a more subjective basis? What are the advantages and risks of either approach? Do you agree with the proposal that where the positions of an entity that is subject to substantial control by a person are aggregated, they are included in their entirety?

In principle, EFET agrees that the notion of control should be the basis of the proposed regime for aggregation of group positions and supports the view that they should benefit from an exemption, i.e. disaggregation, provided controlled undertakings can demonstrate through objective criteria that they operate independently from their parent company.

EFET particularly agrees with the statement of ESMA that aggregation with fellow subsidiaries of a mutual parent or ultimate holding company should not be required.

EFET also calls for the development of other exemptions from aggregation for: (1) certain limited partners, shareholders or other commodity pool participants; (2) accounts held by investment firms, brokers, and similar market intermediaries; (3) accounts carried by an independent account controller; (4) positions held in connection with underwriting activity or a broker-dealer acquired in the normal course of business and (5) information sharing where prohibited by law or regulation.

In the draft RTS dated 20 March 2014 under the revised Transparency Directive (2013/50/EU amending 2004/109/EC) - for the purpose of shareholdings calculation notably through derivatives - ESMA proposes that the parent undertaking of an entity wishing to benefit from the exemption in relation to holdings sets a list of the effectively controlled entities with their competent authorities and a statement that these controlled entities do not receive any direct or indirect instructions from the parent undertaking in the exercise of the voting rights. In addition, EFET understands that the exemption applies to non-EU groups and non-EU controlled undertakings where it can be demonstrated that the relevant undertaking's market making and trading activities as well as its asset management activities meet the independence criteria on an on-going basis as set out in the draft RTS under the Transparency Directive.

Although the purpose of the Transparency Directive is different from the MiFID position limits regime (exercise of voting rights versus positions on commodities), EFET believes that the definitions of the aggregation of positions at a group level should be aligned. EFET however does not support that any ownership percentage between 50% and 100% automatically involves aggregation of positions between the parent undertaking and the subsidiary without any consideration to independence in investment strategies or trading businesses.

Q494: Should the regime apply to the positions held by unconnected persons where they are acting together with a common purpose (for example, "concert party" arrangements where different market participants collude to act for common purpose)?

In principle, EFET supports rules aiming at tracking 'concert parties'. EFET notes that the level 1 text sets out in article 57(12) of MiFID II that ESMA is required to draft RTS only in respect of limited circumstances. Specifically with respect to aggregation, it is required to draft "*the methods to determine when positions of a person are to be aggregated within a group*".

As this notion of 'concert parties' is not referenced in article 57(12), ESMA may not be able to introduce level 2 measures on this point. In any case, if ESMA was to introduce such rules, EFET would support alignment with principles that were enforced under the legislative texts that already use this concept. EFET also believes that "*the circumstances where it is appropriate to aggregate positions even for unconnected persons where they are tied together in a common purpose*" (page 409 of the Discussion paper, Paragraph 20) must be proved by the competent authority in charge of enforcing the position limits regime.

Q495: Do you agree with the approach to link the definition of economically equivalent OTC contract, for the purpose of position limits, with the definitions

used in other parts of MiFID II? If you do not agree, what alternative definition do you believe is appropriate?

Position limits will apply to net positions aggregated at a group level on commodity derivatives contracts covered by the MiFID II as stated in article 57 of MiFID and supported by Recital 127, 130 and 131. However, to accurately reflect the net risk-exposure of market participants, underlying physical positions including non-derivative contracts should be taken into account when determining net positions.

With this in mind, EFET highlights the following points:

- ESMA should set a list of EU listed contracts subject to the limits in order to bring legal certainty to the scope of the position limits regime.

- It is essential that written contracts from different locations should have the same notion of equivalence to ensure that the commodity risk exposures are accurately reflected.

- Since position limits will apply to net positions aggregated at a group level, netting must be allowed also between underlying physical (non-derivative) contracts and the on-venue contract subject to the position limits.

- ESMA should not impose an artificial restriction on the ability to net cash-settled and physically-settled non-derivative contracts if the contracts are economically equivalent. The purpose of level 1, clearly stated in article 57.1 (a), is to 'prevent market abuse' and 'support orderly pricing and settlement conditions'. These objectives go with a definition of netting that reflects the reality of these global markets.

- The industry strongly supports a mechanism that is sufficiently broad and legally clear (i.e. measurable). In this respect EFET believes that the first approach is not sufficiently broad because the criteria are cumulative. EFET also thinks that the implementation in the European Union of the second approach would need to be tailored to meet a much broad pool of contracts rather than the list of 28 contracts subject to position limits in the US, but potentially to all on-venue contracts. However, EFET believes that the second approach offers a more practicable set of equivalence criteria by setting out the specific types of contracts which could be considered to be equivalent and that this type of approach would facilitate implementation. EFET suggests that ESMA considers defining qualitative criteria (which may be the same for certain commodities) per asset class, i.e. a) oil, b) gas and power, c) metals, d) agriculture.

- EFET notes with concern that ESMA's comments in the discussion paper indicate that it intends to interpret economically equivalent OTC contracts as meaning only MiFID financial instruments. In order to ensure a workable netting regime, market participants should be allowed to net against the underlying physical positions, including contracts that are not commodity derivatives (e.g., certain REMIT instruments and other physical contracts, e.g. coal and oil, or spot contracts). This greater pooling of positions and the provision of netting to allow bona fide hedges to be offset against physically settled transactions would facilitate the accurate presentation of commodity risk levels.

• Also, EFET encourages ESMA to consider the need for "proxy hedging" when considering economically equivalent OTC contracts. Proxy hedging occurs when a risk related to a particular product is managed by hedging with a different product. For example, a participant may choose to hedge jet fuel exposure with ICE Europe Gas Oil Futures Contracts, since this ICE futures contract is both a key price determinant in European jet fuel markets and a highly liquid risk management tool. For the market to function as efficiently as possible and for all participants to have the ability to continue to offer, and benefit from, price risk management services, the position limit regime should allow for netting between proxy hedging contracts as economically equivalent contracts.

• EFET recognises that there are challenges in defining proxy hedging contracts and in this regard refer ESMA to the CME Group rules and guidance on Exchange for Related Position (EFRP) transactions. EFRP's are used by market participants to establish, move or liquidate exchange positions by executing the exchange product versus an OTC contract. There are several types of EFRPs, including an Exchange of Futures for Physical (EFP), which is defined as, "the simultaneous execution of an Exchange futures contract and a corresponding physical transaction or a forward contract on a physical transaction." In determining what may qualify for the physical component of the EFP the CME Group provides the following in its guidance (see link provided):

"The related position component of the EFRP must involve the product underlying the Exchange contract or a by-product, related product or OTC derivative instrument that is reasonably correlated to the corresponding Exchange instrument.

The related position component of an EFRP may not be a futures contract or an option on a futures contract.

Where the risk characteristics and/or maturities of the related position differ from the instrument underlying the Exchange contract, the parties to the EFRP may be required to demonstrate the correlation between the products and the methodology used in equating the futures to the related position. In all cases, the related position transaction must be comparable with respect to quantity, value or risk exposure of the corresponding Exchange contract."

http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/files/RA1311-5.pdf

The CME Group rules and guidance highlight both the need for proxy hedging capabilities and a general level of accepted market practice. ESMA requests suggested amendments to the second approach to determining economically equivalent OTC contracts (see Q497). EFET suggests that the CME Group rules and guidance on EFP transactions could be considered as the basis of an additional proxy hedging criterion for economically equivalent OTC contracts under the second approach.

Q496: Do you agree that even where a contract is, or may be, cash-settled it is appropriate to base its equivalence on the substitutability of the underlying physical commodity that it is referenced to? If you do not agree, what alternative measures of equivalence could be used?

EFET generally agrees that it would be appropriate to base equivalence on the substitutability of the underlying commodity for such contracts. This is consistent with the legislative text in MiFID II which calls for a determination of economic equivalence. EFET emphasises that there must be genuine economic substitutability, i.e. fungibility, between cash-settled and physical-delivery contracts. Netting across cash-settled and physical delivery contracts is critical as segregating cash settled and physically delivered contracts could fragment the market and could push liquidity towards fewer markets.

Q497: Do you believe that the definition of "economically equivalent" that is used by the CFTC is appropriate for the purpose of defining the contracts that are not traded on a trading venue for the position limits regime of MiFID II? Give reasons to support your views as well as any suggested amendments or additions to this definition.

EFET generally supports a broad approach to OTC economically equivalent, however EFET believes that the CFTC approach is too indefinite for the European context, especially considering that in the US case only a restrict number of referenced contracts is subject to Position Limits whilst in the EU all commodity derivatives are in scope. Therefore a broad and objective approach would be preferable.

Q498: What arrangements could be put in place to support competent authorities identifying what OTC contracts are considered to be economically equivalent to listed contracts traded on a trading venue? ?

Once the definition of economically equivalent OTC contracts is set with sufficient width and certainty, then the implementation and supervision will be much easier. EFET therefore believes that the response to this question largely depends upon the definition of economically equivalent OTC contracts. EFET also believes that CCPs and trading venues will be essential in conveying the necessary data for determining economically equivalent positions to listed contracts. Competent authorities may consider publishing examples of what they consider to be economically equivalent OTC contracts by commodity asset class as this would facilitate consistent interpretation and implementation (based on qualitative criteria par asset class). The lists would not be exhaustive but would aim to provide guidance.

Q499: Do you agree with ESMA's proposal that the "same" derivative contract occurs where an identical contract is listed independently on two or more different trading venues? What other alternative definitions of "same" could be applied to commodity derivatives?

EFET agrees that the 'same' derivative contract is a subset of economically equivalent contract and that in addition to the criteria for recognising economically equivalent contracts, other elements have to be taken into account such as the settlement process.

The intention of article 57(6) of MiFID II is to apply a single position limit across multiple trading venues where "the same" contract is traded. However, as a practical matter, EFET questions if ESMA will be able to monitor and to resolve disputes with respect to position limits, in respect of trading venues located outside the EU. The example used in paragraph 35, page 412, of the discussion paper, is of the KOSPI 200 contract traded on Eurex and the Korea Exchange, is helpful. However, EFET does not see how the German regulator could impose its own position limits on the South Korean trading venue where there is no such regime.

EFET also strongly believes that the concept of 'same contract' is to be used only for the purpose of article 57(6) and shall not be used for the purpose of netting and calculation of net positions aggregated at a group level).

Q500: Do you agree with ESMA's proposals on aggregation and netting? How should ESMA address the practical obstacles to including within the assessment positions entered into OTC or on third country venues? Should ESMA adopt a model for pooling related contracts and should this extend to closely correlated contracts? How should equivalent contracts be converted into a similar metric to the exchange traded contract they are deemed equivalent to?

On aggregation of contracts (for aggregation at a group level, please see our response to question 493), EFET agrees that same contracts and OTC economically equivalent contracts should be included within the calculation. When facilitating client trades where there is limited liquidity in the specific underlying contract, investment firms use hedging strategies across many geographies, markets, products and time horizons to manage their residual risk. The regime should allow for this approach.

On netting, EFET considers that the calculation of a market participant's position should be with respect to its net position on a portfolio basis for identical or correlated commodities (e.g. gasoil / oil, power / emissions) across different commodity markets and on third country venues (if considered significant for EU markets for example, COMEX or WTI) in order to accurately represent commodity risk levels.

Naturally, EFET would caution against any extra-territorial application of EU position limits to contracts on third country venues; this would not be supported by the level 1 text and, practically speaking, if implemented could lead to conflicting rules and requirements applying to the same position.

With respect to cross-commodity hedges, EFET recommends that ESMA reviews and takes into account the CFTC rules for cross-commodity hedges including quantitative (i.e. setting of correlation limits) and qualitative (i.e. commercial relationship between target commodity and commodity underlying the derivative contract) factors. EFET notes, however, that ESMA should not impose a rigid quantitative test for determining what constitutes a permissible cross-commodity hedge e.g. a specific correlation requirement. While this may seem an attractive policy option it has major limitations due to the fact that many commodity markets do not have liquid exchange-traded derivatives that can be used as a hedge. In such cases, market participants must hedge their risk using related derivatives products even though these hedges are not perfect i.e. ICE's Brent Contract is used to hedge a significant number of energy commodities. A qualitative test that is based on specific facts and circumstances and defers to the reasonable judgment of market participants is most appropriate.

Finally, EFET believes that it is essential for gas and electricity derivatives that the geographical scope of position limits is set at European level rather than at national markets, considering the efforts to establish the Single Energy Market. This would also solve the problem of related derivative products in the field of gas and electricity.

Q501: Do you agree with ESMA's approach to defining market size for physically settled contracts? Is it appropriate for cash settled contracts to set position limits without taking into account the underlying physical market?

Deliverable supply is the most reasonable metric for physically settled and cash settled spot month contracts. It is not appropriate for position limits to be set for cash settled contracts without taking into account the underlying physical market. EFET also believes that although they are expressed as percentage of open interest, limits on cash-settled spot month contracts should be as aligned as possible with limits applied to physically-settled spot month contracts.

In relation to the use of open interests for limits on physical and cash settled non-spot month contracts, as the MiFID II regime applies to a broader range of commodity derivatives than just futures and will include economically equivalent OTC contracts, it will be necessary to adjust the open interests (given it is a futures related metric) to add the notional volumes of swaps relating to the relevant on-venue contract. It is also the case that certain commodities may not have a related futures contract and competent authorities will need to estimate the open interests based on notional amounts of swaps.

EFET also calls ESMA to provide further details on how ESMA intends to determine the overall market size for securities contracts with a commodity underlying.

EFET highlights that there are significant implementation issues that need to be considered further. In particular: (i) the definition of deliverable supply/open interest and (ii) ensuring that the deliverable supply/open interest is based on reliable, accurate and current information. For example:

- For ICE Europe Brent crude oil futures contract "...is a deliverable contract based on EFP delivery with an option to cash settle against the ICE Brent Index price for the last trading day of the futures contract. The Exchange shall publish a cash settlement price (the ICE Brent Index price) on the next trading day following the last trading day for the contract month"

This ICE Europe futures example highlights the difficulty in determining deliverable supply for a particular contract as effectively any crude oil can form the basis of an EFP transaction for the purposes of settling the ICE Europe Brent crude oil futures contract. This example also highlights the difficulty in sourcing reliable, accurate and current data to determine deliverable supply.

Also, the difference between commodities means that some are durable and can be stored indefinitely and some cannot; this means that for some commodities as well as production deliverable supply should also include stock levels (i.e. surplus production stored from a prior period).

EFET notes that in this section the discussion paper addresses the notification and approval of exemptions (paragraph 43, page 413). It is very unclear how such mechanism should work in practice without being burdensome and potentially disruptive of markets and hedging conditions.

For the sake of effective and smooth implementation and supervision, EFET strongly supports a notification process that works on the basis of assumption that the exemption is approved until and unless it is explicitly rejected. In other words: market participants shall notify the competent authority before breaching the position limit; the notification should be based on a web service; the exemptions shall be considered as accepted by until and unless it is explicitly rejected. Upon rejection, the market participant is required to reduce its positions in a reasonable timeframe. This solution would allow markets to continue to work whilst minimising the burden of the approval procedure.

Q502: Do you agree that it is preferable to set the position limit on a contract for a fixed (excluding exceptional circumstances) period rather than amending it on a real-time basis? What period do you believe is appropriate, considering in particular the factors of market evolution and operational efficiency?

EFET agrees that amending the position limit on a real-time basis is unnecessary and unfeasible with the current IT systems set up. Setting position limits for a pre-defined period (excluding exceptional circumstances) is highly preferable. With regard to the period itself, EFET proposes that position limits on a contract are set for an initial period of two years and with annual reviews thereafter with amendments to the limits only where necessary.

EFET also believes that spot month limits generally should not be determined at the time a contract month becomes the spot month. Determining a position limit for the spot month contract on the first day that such contract is available for trade is impractical as it would require notice of a limit to be provided when that contract has already commenced trading (open interest calculations are usually published after trading has begun each day) and when parties may already be holding positions that are in breach of that new position limit. Requiring parties to trade out of positions to comply with the new position limits may lead to artificial volatility and a disorderly market.

The implementation of a position limits regime will impose significant changes on the functionality of the commodity markets and this initial two year period is necessary to ensure that orderly trading conditions are maintained during the transition.

The measure of the deliverable supply for a period of time is challenging and ESMA and national regulators should rely on data gathered by exchanges and on existing database aiming to ensure transparency in physical markets. A one-size fits all approach such as the "three months expiry cycle" as proposed by ESMA may not fit the fundamentals of certain commodity markets.

EFET also highlights that data used for the purpose of defining the deliverable supply period per commodity type should span over a period of a minimum of three years and should have a granular view on a monthly basis. When calculating the deliverable supply period per commodity type, different factors must be included, among which, a basic taxonomy (i.e.: storable versus non-storable), weather, supply chain optimization level, demand and offer curve, geographical location-distance, seasonality, growth, and market concentration, as well as the trading cycles per each commodity market. As there would be differences across commodities and that some factors are outside of the control of either of the parties to the physically-settled contract, a +/-margin should be added to the averaged/estimated delivery supply period. This +/- margin could be set at no less than 15% of the overall delivery supply period.

Q503: Once the position limits regime is implemented, what period do you feel is appropriate to give sufficient notice to persons of the subsequent adjustment of position limits?

The period must be sufficiently long to ensure that the adjustment does not disrupt the market. Many commodity derivatives markets are by nature illiquid and the brutal adjustment by a major market participant could create stressed conditions in the concerned market.

EFET supports that the notice/adjustment period should be at least half the time of the set period however if grandfathering is allowed then a 3 to 6 month adjustment period is considered to be manageable.

Q504: Should positions based on contracts entered into before the revision of position limits be grandfathered and if so how?

Yes, EFET strongly supports grandfathering of contracts entered into before the revision of position limits. The immediate application of new stringent rules can adversely impact illiquid markets. Many commodity derivatives markets are illiquid by nature and the immediate application of limits to existing contracts may increase the disruption of the markets and create the conditions for higher volatility and price spikes which is exactly what the position limits regime aims to prevent or mitigate.

EFET also believes that staged compliance could be implemented following revision of position limits to ensure that market disruption is minimised.

Q505: Do you agree with ESMA's proposals for the determination of a central or primary trading venue for the purpose of establishing position limits in the same derivative contracts? If you do not agree, what practical alternative method should be used?

Yes. EFET agrees that the application of the rule should be limited to the same commodity derivatives contract that is traded on two or more trading venues within the EU.

EFET agrees with the method proposed by ESMA to assess whether the contract is traded in significant volumes in another jurisdiction. EFET also agrees that the measure of the largest volume of trading shall be based on the largest volume of open interests measured in the number of lots of the relevant contracts.

Lastly, EFET reiterates that the concept of 'same contract' is to be used only for the purpose of article 57(6) and shall not be used for the purpose of netting and calculation of net positions aggregated at a group level.

Q506: Should the level of "significant volume" be set at a different level to that proposed above? If yes, please explain what level should be applied, and how it may be determined on an ongoing basis?

No. EFET agrees with the approach proposed by ESMA. EFET obviously recognises that the revision of the measure of the 'significant volume' should be subject to the same principles as the revision of the position limits itself.

EFET agrees that amending the position limit on a real-time basis is not only unnecessarily but unfeasible and that setting it for a fixed (excluding exceptional circumstances) period is preferable. With regard to the period itself, EFET proposes that position limits on a contract are fixed for an initial period of two years and with annual reviews thereafter with amendments to the limits only where necessary.

EFET also believes that spot month limits generally should not be determined at the time a contract month becomes the spot month. Determining a position limit for the spot month contract on the first day that such contract is available for trade is impractical as it would require notice of a limit to be provided when that contract has already commenced trading (open interest calculations are usually published after trading has begun each day) and when parties may already be holding positions that are in breach of that new position limit. Requiring parties to trade out of positions to comply with the new position limits may lead to artificial volatility and a disorderly market.

The implementation of a position limits regime will significantly affect the functioning of the commodity markets and for this reason an initial two year period is necessary to ensure that orderly trading conditions are maintained during the transition.

The measure of the deliverable supply for a period of time is challenging and ESMA and national regulators should rely on data gathered by exchanges and on existing database aiming to ensure transparency in physical markets. A one-size fits all approach such as the "three months expiry cycle" as proposed by ESMA may not fit the fundamentals of certain commodity markets.

EFET also highlights that data used for the purpose of defining the deliverable supply period per commodity type should span over a period of a minimum of three years and should have a granular view on a monthly basis. When calculating the deliverable supply period per commodity type, different factors must be included, among which, a basic taxonomy (i.e.: storable versus non-storable), weather, supply chain optimization level, demand and offer curve, geographical location-distance, seasonality, growth, and market concentration, as well as the trading cycles per each commodity market. As there would be differences across commodities and that some factors are outside of the control of either of the parties to the physically-settled contract, a +/- margin should be added to the averaged/estimated delivery supply period. This +/- margin could be set at no less than 15% of the overall delivery supply period.)

Q507: In using the maturity of commodity contracts as a factor, do you agree that competent authorities apply the methodology in a different way for the spot month and for the aggregate of all other months along the curve?

EFET fully agrees that competent authorities apply the methodology in a different way for the spot month and to all other months along the curve, considered in aggregate. EFET highlights that not all commodity markets follow the same vanilla date structure.

Therefore EFET believes that ESMA should clarify how to interpret the definition of spot month when taking into account markets with daily prompts.

Q508: What factors do you believe should be applied to reflect the differences in the nature of trading activity between the spot month and the forward months?

Financial markets are structured to achieve price convergence between physical and financial commodity markets, and for futures markets to act as effective risk hedging venues for physical commodities. Settlement prices typically converge with physical market prices at expiry.

'Spot' or 'delivery' month limits restrict how many contracts a participant can hold in the period during which delivery of the physical commodity is to be made. This is when possible market squeezes can occur and dominant market positions can have the most acute effect.

Further down the curve, however, position limits may be less effective given reduced liquidity for long-dated contracts. Market squeezes and dominant market positions are much more difficult to achieve in the non-spot months because markets have sufficient time to react and counter them. EFET therefore strongly supports the statement of ESMA in point 90 that all months' forward position limits in subsequent maturities should act as 'a warning mechanism to prevent a build-up of positions that may, if maintained over time, become a concern as they become near prompt'.

EFET also believes that it is important to take account of contract design and related specifications in addition to deliverable supply. Market distortions do not simply arise due to the size of the position built by a market participant in a particular commodity but also can arise due to the manner in which a contract is designed.

In certain cases, using deliverable supply alone as the single determining factor when setting a position limit for a commodity is insufficient as it is also necessary to take into account specific characteristics of that commodity, for example, logistical constraints i.e. ease with which the commodity can be delivered or extracted given contract delivery points.

Q509: Do you agree with ESMA's proposal for trading venues to provide data on the deliverable supply underlying their contracts? If you do not agree, what considerations should be given to determining the deliverable supply for a contract?

Yes, EFET generally agrees that in the first instance the competent authority of the jurisdiction where a trading venue is located should obtain and use the data on deliverable supply that is maintained by that trading venue. However, especially for gas and electricity markets EFET believes that the final source of information on deliverable supply should be the system operators (including operators of transportation, storage and regasification facilities).

In gas and electricity European Network of Transmission System Operators for Gas and Electricity (ENTSOG and ENTSOE) are the associations of Europe's transmission system operators that aim to promote the completion and cross-border trade for gas and electricity European internal market and development of the European natural gas transmission networks.

The ENTSOs should be involved together with Agency of European Energy Regulators (ACER) in order to define the role in providing data on deliverable supply either to trading venues or directly to National Competent Authorities or ESMA.

The involvement of European entities will support the objective of defining an EU-wide position limits' regime.

Further, where a contract is a key benchmark and is used as a proxy hedge for other commodities e.g. ICE Gasoil contract which is used to hedge jet derivatives, then the position limit regime should reflect this wider market.

This is because the exchange's view of deliverable supply will be focused on the specifics of its contract, whereas the MiFID position limit regime covers a wider universe.

EFET also fully supports the G20 initiatives aiming to enhance the transparency in physical commodity markets (production and storage) though EFET highlights that on some commodities (precious metals and rare earths for instance) such a transparency does not yet exist, primarily because of the reluctance of some countries in a dominant position to publish relevant data on a regular basis.

Q510: In the light of the fact that some commodity markets are truly global, do you consider that open interest in similar or identical contracts in non-EEA jurisdictions should be taken into account? If so, how do you propose doing this, given that data from some trading venues may not be available on the same basis or in the same timeframe as that from other trading venues?

Yes, EFET believes that a harmonised regime globally for key economically-linked contracts both exchange traded and OTC is critically needed where the fundamentals of the underlying commodity markets are global. It would be a grave concern if a global commodity such as, for instance, gold, which is traded on different markets, has to have different position limits depending on whether it falls within the CFTC regulation or the EU MiFID regime.

Coordination between relevant EU and non-EU competent authorities having access to regional or national trade repositories is essential to measure the overall size of the relevant commodity derivatives markets. In other words, open interest in similar or identical contracts in non-EU jurisdictions should be taken into account. Imposing limits that do not reflect the global nature of commodity markets would cause substantial fragmentation and would be detrimental to beneficial risk management activities.

Q511: In the absence of published or easily obtained information on volatility in derivative and physical commodity markets, in what ways should ESMA reflect this factor in its methodology? Are there any alternative measures that may be obtained by ESMA for use in the methodology?

EFET in general believes that volatility is not a relevant criterion for the purpose of the calculation methodology of limits and EFET does not clearly see at this time how ESMA proposes to incorporate volatility into position limit calculations.

Volatility is natural to markets and reflects the market adjusting to new information. If regulators believe that the effect is driven by some sort of abuse they have sufficient powers under MAR to take action. EFET does not believe that position limits prevent volatility. There is evidence that in some cases limits may even lead to increased volatility if they are inappropriately calibrated.

The presence of volatility in a market generally leads participants to seek risk management solutions and any restriction on participants' ability to do so through the use of position limits may prohibit participants from effectively managing their risks. Further, where limits are revised down at short notice in response to increasing volatility, this may further exacerbate volatility as participants are forced to close down positions to meet the new limits. Historically, regulated markets have used margin methodologies to manage volatility. Parties unable to maintain positions in volatile markets may have to reduce positions due to margin call, but there is no artificial constraint in their ability to participate.

EFET therefore requests ESMA to undertake a further review of the impact of volatility before including any volatility based adjustment factor in the position limit methodology.

At the very least, ESMA should clarify whether volatility in this particular context is intended to refer to price volatility or to the amount of the commodity available in the market.

EFET agrees that the absence of accurate data on all physical markets makes it difficult to measure volatility of these markets. Given that volatility usually results from a lack of liquidity, EFET believes that position limits should be set high enough to take into account volatility of the physical markets and the consequences that volatility has on trading volumes e.g. fewer new market participants the higher the volatility.

Q512: Are there any other considerations related to the number and size of market participants that ESMA should consider in its methodology?

EFET agrees with ESMA's views on the size and number of market participants and does not see any other consideration. EFET also supports ESMA's statement on point 77 of the discussion paper that this may be especially relevant for gas and electricity markets that are characterised by national champions and relevant suppliers on the underlying. Therefore, once again, to overcome such an issue EFET recommends the adoption of EU-wide position limits.

EFET also believes that where a product is traded by a small number of participants, ESMA should seek to understand the composition of market participants before determining the position limit. For example, a market with ten active participants may have two sellers and eight buyers, or just one risk management provider amongst nine participants seeking risk management services. In such markets, a single position limit may have a disproportionate impact on some of the participants.

Q513: Are there any other considerations related to the characteristics of the underlying commodity market that ESMA should consider in its methodology?

EFET agrees with ESMA's views that the seasonal supply outages in the physical market, the perishability of deliverable materials and the capacity constraints (with regard to transportation and delivery) should be taken into account. EFET reiterates that the absence of accurate data on production and storage of some commodities should be reflected in the consideration related to the characteristics of the underlying commodity market.

EFET reiterates the need to involve the system operators in case of gas and electricity markets, since information on deliverable supply are widely available, although not in a timely and consistent manner as market participants would like to see.

Q514: For new contracts, what approach should ESMA take in establishing a regime that facilitates continued market evolution within the framework of Article 57?

Firstly, EFET recognises there will be difficulties in determining position limits for new contracts. EFET therefore encourages ESMA to consider mechanisms to ensure that the limits do not damage developing liquidity in the new contracts. Low liquidity is not only a characteristic of new contracts, but also of many more regional or specialised commodity products. Where very few market participants exist with respect to a contract, liquidity will naturally be limited. Any consideration and/or methodology adopted for new contracts should therefore be extended to existing illiquid contracts.

EFET believes that the best approach would be to take each new or illiquid contract separately and consider a reasonable multiple of the current transaction size after a defined period of trading, so approach 1.

EFET also thinks that, instead of position limits, ESMA should consider relying on the position management powers available to national regulators and trading venues. New contracts often are illiquid/ immature initially and may be used by a small number of market participants. In order to accommodate the demand of hedgers and develop a robust, established market, it may be necessary to permit a small number of market participants to represent a relatively large share of the (small) market. Concerns regarding market abuse can be adequately addressed through enhanced reporting and surveillance, as necessary.

Q515: The interpretation of the factors in the paragraphs above will be significant in applying ESMA's methodology; do you agree with ESMA's interpretation? If you do not agree with ESMA's interpretation, what aspects require amendment?

EFET broadly agrees with ESMA's views on the various factors that should be taken into account in the calculation methodology. EFET however reiterates that volatility is probably not a relevant tool for this purpose.

Q516: Are there any other factors which should be included in the methodology for determining position limits? If so, state in which way (with reference to the proposed methodology explained below) they should be incorporated.

Where a liquid benchmark contract is used as a proxy or a generic hedge for a range of contracts, the position limits should be set at a level to allow this bona fide hedging activity to continue.

Q517: What do you consider to be the risks and/or the advantages of applying a different methodology for determining position limits for prompt reference contracts compared to the methodology used for the position limit on forward maturities?

The methodology should be possible to apply differently, though deliverable supply should be considered in all cases.

In terms of non-spot maturities, a complementary instrument to the warning mechanism as described in point 90 may be a requirement to disclose position upon coming within a certain range supplementing by reason for holding such a position. This would promote greater transparency for the market and regulators while not artificially restricting liquidity in contracts that are not subject to logistical constraints.

EFET also notes that the CFTC's proposed position limits regime differentiate spot and forward maturities as follows: Spot month limit levels are set at 25% of estimated deliverable supply (separately for physical-delivery and cash-settled Reference Contracts) determined by the exchange that lists the Core Referenced Futures Contract, unless CFTC chooses to rely on its own estimate – and may not be greater than 25% of such supply but not less than 1,000 lots for agricultural commodities and not less than 5,000 lots for energy / metal commodities. Each month (i.e. single month) and all-months-combined limits, which are set at the same level, are based on largest average annual open interest in Reference Contracts in the preceding two years (10% of open interest for first 25,000 contracts and 2.5% thereafter).

Q518: How should the position limits regime reflect the specific risks present in the run up to contract expiry?

The position limits regime could introduce "telescoping" limits to avoid market disruption. This would involve stating limits in the immediate period prior to contract expiry.

Q519: If a different methodology is set for the prompt reference contract, would it be appropriate to make an exception where a contract other than the prompt is the key benchmark used by the market?

EFET does not think that instances where a contract month other than prompt is primarily used as the "key benchmark contract" should cause particular problems. The key risk being addressed by limits is abusive squeezes occurring as the contract approaches expiry; spot month limits will ultimately apply to all contract maturities as they approach expiry, regardless of whether some months are more traded than others; ESMA is also anticipating applying back month limits, which would govern all contract maturities outside of the spot month, which could apply to the "key benchmark contract" when spot month limits are not currently in effect.

Q520: Do you agree that the baseline for the methodology of setting a position limit should be the deliverable supply? What concrete examples of issues do you foresee in obtaining or using the measure?

As stated in our response to question 501:

Deliverable supply is the right metric for physically settled spot month contracts. For cash settled spot-month contracts, EFET believes that the metric should be the open interest.

EFET also believes that although they are expressed as percentage of open interest, limits on cash-settled spot month contracts should be as aligned as possible with limits applied to physically-settled spot month contracts.

In relation to the use of open interests for limits on physical and cash settled non-spot month contracts, as the MiFID II regime applies to a broader range of commodity derivatives than just futures and will include economically equivalent OTC contracts, it will be necessary to adjust the open interests (given is a futures related metric) to add the notional volumes of swaps relating to the relevant on-venue contract. It is also the case that certain commodities may not have a related futures contract and competent authorities will need to estimate the open interests based on notional amounts of swaps.

EFET also calls ESMA to provide further detail on how ESMA intends to determine the overall market size for securities contracts with a commodity underlying.

Q521: If you consider that a more appropriate measure exists to form the baseline of the methodology, please explain the measure and why it is more appropriate. Consideration should be given to the reliability and availability of such a measure in order to provide certainty to market participants.

In determining its methodology for the setting of position limits for physically delivered contracts ESMA should consider not only the defining of deliverable supply, but equally importantly the capacity for determination of deliverable supply. Criteria in determining the deliverable supply must be crystal clear to market participants.

Whether a trading venue or other related body is identified as the responsible calculation party, the ability for any one body to determine deliverable supply is limited by the scope of information available. For example, for medium to long term supply calculations, industry and government sponsored organisations (such as the International Energy Agency or, for oil, the OPEC reports) may have well established processes for determining structural supply and demand data, but for shorter term calculations it would most likely be the market participants that would be the key data providers for deliverable supply calculation.

In recommending a trading venue being responsible for determination of deliverable supply it is critical to provide a framework that enables the venue to access all relevant data and participants. In considering a more suitable calculation agent ESMA must consider the same availability and transparency of data. In support of the trading venue being the calculation agent, the availability of trading data across that particular venue may enable it to direct its focus to those participants most active in the relevant product most immediately and more effectively.

EFET reiterates the recommendation to involve the system operators in case of gas and electricity markets, since information on deliverable supply and related capacity are widely available.

It should be noted by ESMA that commodity markets can exhibit very rapid changes in supply and demand balances given the global nature of those markets (where product may move in and out of region frequently given supply/demand/pricing arbitrage, and production volumes in some commodities can change very rapidly). As a result the deliverable supply, particularly where a defined set of criteria is used to determine that supply, can change dramatically and very rapidly. Shorter term supply calculations could, and would likely, exhibit a level of volatility that can disrupt the efficient functioning of the market if this short term supply volatility is manifested in rapidly changing position limits based on deliverable supply.

Q522: Do you agree with this approach for the proposed methodology? If you do not agree, what alternative methodology do you propose, considering the full scope of the requirements of Article 57 MiFID II?

EFET supports the expression of the limits as percentage of open interests (for non-post month cash-settled and physically-settled contracts,) or deliverable supply (for spot month contracts). EFET notes that open interest will need to be adjusted to take into account the notional value of swaps given open interest for the relevant contract will be applied to OTC equivalents.

Q523: Do you have any views on the level at which the baseline (if relevant, for each different asset class) should be set, and the size of the adjustment numbers for each separate factor that ESMA must consider in the methodology defined by Article 57 MiFID II?

It is difficult to suggest a single level for setting the baseline. However, EFET believes that ESMA should take a cautious approach with the aim to avoid affecting liquidity in commodity derivative markets. In this sense limits should be set initially at a sufficient high level until information on deliverable supply and position reporting will be made available to market participants.

Only after such information will be published, national competent authorities will be able to take ‘informed decisions’ by adjusting the baseline where necessary.

Q524: Does the approach to asset classes have the right level of granularity to take into account market characteristics? Are the key characteristics the right ones to take into account? Are the conclusions by asset class appropriate?

The characteristics for each class outlined by ESMA relate to the relevant exchange contract not necessarily the OTC and physical markets and these differences will need to be recognised when applying a limit. However, in general EFET thinks the granularity of the taxonomy is acceptable e.g. oil and oil products class should allow for the hedging of oil products without exchange contracts via ICE’s Brent Contact.

Q525: What trading venues or jurisdictions should ESMA take into consideration in defining its position limits methodology? What particular aspects of these experiences should be included within ESMA’s work?

EFET believes that all venues should be taken into account. EFET thinks that in addition to consulting with the relevant trading venues, ESMA should continue working closely with the CFTC on harmonising their approaches.

The key consideration in defining the EU position limits methodology is harmonisation. EFET also strongly believes that alignment of position limits regimes will improve results and provide a powerful data set for regulators to develop accurate and more useful tools to achieve their objectives. Inconsistencies across regimes will make systems harder to build and implement across global trading businesses.

Q526: Do you agree that the RTS should accommodate the flexibility to express position limits in the units appropriate to the individual market? Are there any other alternative measures or mechanisms by which position limits could be expressed?

Expression of limits as percentage of open interest or deliverable supply is the most appropriate way. But as long as the measure of the physical underlying market is taken into consideration, flexibility may make sense in some limited cases.

Q527: How should the methodology for setting limits take account of a daily contract structure, where this exists?

In gas and electricity markets contracts are normally settled respectively on a daily and hourly basis. In derivative contracts on exchanges a so called ‘cascading’ process applies.

Cascading means that futures contracts with longer delivery periods are replaced by equivalent futures contracts of shorter duration: at (or closely to) the end of the session of the last day of trading for a specific contract, the positions on the yearly contract are split into equivalent positions on contracts of shorter maturity (monthly and quarterly). In this case, the positions are closed at the final settlement price of the year future or quarter future and the equivalent new positions in futures with a shorter period are opened at the final settlement price.

The position closed for expired periods are normally settled on a monthly basis. In this context EFET believes that position limits as defined in level I should only refer to the spot-month and all other months contracts open at any point in time. EFET does not believe that position limits should apply to contracts with validity shorter than the spot month. It may become extremely burdensome to manage.

Finally, it should be clearly acknowledged that spot contracts are not subject to the position limit regime not being commodity derivatives.

Q528: Do you agree that limits for option positions should be set on the basis of delta equivalent values? What processes should be put in place to avoid manipulation of the process?

Yes. During the lifetime of the option, in order to minimise risk, the hedge for the option will replicate the change in delta (as opposed to the absolute value of the option). Therefore, in setting limits for options position limits should track the option delta. Regarding anti-manipulation, calculation methodology can be subject to retrospective audit from the relevant national regulator, upon request. Also, in the event options are used to hedge futures it is critical that option deltas are able to be netted with futures positions delta in order to accurately reflect commodity risk levels.

Q529: Do you agree that the preferred methodology for the calculation of delta-equivalent futures positions is the use of the delta value that is published by trading venues? If you do not, please explain what methodology you prefer, and the reasons in favour of it?

As market participants will have different internal calculation methodology for calculating delta futures equivalent values, to ensure consistency with internal risk systems they should be allowed the flexibility to use their own calculations rather than those delta value published by trading venues (subject to being able to justify the calculation).

Q530: Do you agree that the description of the approach outlined above, combined with the publication of limits under Article 57(9), would fulfil the requirement to be transparent and non-discriminatory?

Yes, EFET fully agrees with this approach.

Q531: What challenges are posed by transition and what areas of guidance should be provided on implementation? What transitional arrangements would be considered to be appropriate?

EFET believes that ESMA should take a cautious approach when introducing position limits with the aim to avoid affecting negatively liquidity in commodity derivative markets. In this sense limits should be set initially at a sufficient high level until information on deliverable supply and position reporting will be made available on regular basis to market participants. Only after such information will be published, national competent authorities will be able to take 'informed decisions' by adjusting the baseline where necessary.

At a minimum, the grandfathering of existing positions at the time of implementation of the new regime, along with setting of "high limits" which can be calibrated over time, is required in order to avoid market disruption and mismatched hedging.

7.3. Position Reporting

Q532: Do you agree that, in the interest of efficient reporting, the data requirements for position reporting required by Article 58 should contain elements to enable competent authorities and ESMA to monitor effectively position limits? If you do not agree, what alternative approach do you propose for the collection of information in order to efficiently and with the minimum of duplication meet the requirements of Article 57?

EFET questions the appropriateness of setting up a position reporting for commodities. EFET does not understand why this specific position reporting is to be put in parallel to EMIR reporting, where the same information is supposed to end up anyway. They consequently do not see the additional value of this specific reporting. EFET believes that ESMA could simply filter the information collected by Trade Repositories for purposes of monitoring their position limits regime.

Setting up a separate reporting regime for MiFID not only adds complexity, it is also prone to error if the relevant data and fields are not taken over from EMIR. Market participants would like to avoid a separate reporting chain, as this is just costly duplicity.

EFET supports the expressed will to standardise the data definitions and the format of the reporting information required by MiFID with other existing legislative texts to the greatest extent possible in order to reduce the quantity of duplicative reporting.

In the view of EFET, wherever possible, ESMA should establish reporting requirements and data standards that are equivalent to, or at least compatible with, analogous requirements imposed (or proposed) by other jurisdictions. For instance, EFET believes that an appropriate comparison for regulators would be CFTC form 102 and 204, and the data required to be reported pursuant to Parts 15 through 20 of the CFTC's rules. In case the US and EU standards were not compatible, this would result in significant additional costs on the industry, and increase the risk of market disruption and fragmentation.

This should be duly considered by ESMA in the context of MiFID II position reporting, MiFIR transactions reporting and EMIR transaction reporting.

Also, in EU energy markets market participants are subject to transaction reporting in wholesale energy products. Whilst duplication about this regime and the financial is avoided, still market participants must develop different and parallel projects with separate characteristics, infrastructures, data-fields and purposes.

EFET appreciates and supports market transparency but over-complexity must be avoided as this may ingenerate confusion and would increase the financial resources necessary to comply with parallel and – sometimes- overlapping but distinct obligations.

Q533: Do you agree with ESMA's definition of a "position" for the purpose of Article 58? Do you agree that the same definition of position should be used for the purpose of Article 57? If you do not agree with either proposition, please provide details of a viable alternative definition.

Yes, EFET agrees that the definition of 'position' under article 58 should be aligned with the definition under article 57 since the position reporting requirements aim to support the position limit regime. Position reporting, as position limits, should be only applied to commodity derivatives.

Q534: Do you agree with ESMA's approach to the reporting of spread and other strategy trades? If you do not agree, what approach can be practically implemented for the definition and reporting of these trades?

Article 58 only requires that positions that are risk reducing transactions (i.e. netting applies to the calculation of the overall position of the market participant for the calculation of the limits but not to reporting) should be reported gross.

Any additional reporting is duplicative and unnecessary given that investment firms will already be reporting transactions. Looking at a gross position does not provide any regulatory useful information nor is it the way that exchanges current receive position reports. Those positions that are not used for the purposes of 'risk reducing' should be reported net.

Any requirement to report spread and other complex trades on a disaggregated basis should be consistent with the reporting requirements imposed by other jurisdictions. For example, in certain circumstances, market participants should be permitted to report positions based on a diversified commodity index on a consolidated basis (e.g., where the index is commonly known and the weightings of individual components are publically available).

Q535: Do you agree with ESMA's proposed approach to use reporting protocols used by other market and regulatory initiatives, in particular, those being considered for transaction reporting under MiFID II?

Yes, EFET agrees with ESMA's approach to use reporting protocols used for other transactions reporting under MiFID II. Again, EFET urges ESMA to introduce proportionate regulation considering the overall impact on market participants in terms of costs and benefits of introducing new reporting regime. EFET encourages ESMA to optimise the information flows for regulatory purposes.

Q536: Do you have any specific comments on the proposed identification of legal persons and/or natural persons? Do you consider there are any practical challenges to ESMA's proposals? If yes, please explain them and propose solutions to resolve them.

The proposal of EFET to use LEI, BIC, national code waterfall logic will mean existing EMIR reporting methodology can be leveraged minimising new builds and facilitating implementation.

Q537: What are your views on these three alternative approaches for reporting the positions of an end client where there are multiple parties involved in the transaction chain? Do you have a preferred solution from the three alternatives that are described?

EFET agrees with ESMA's proposal that the determination of the central competent authority to which position reports are made should be decided solely by the volume of activity undertaken on exchanges does not take into account that the level of activity is likely to change from time to time, meaning that the relevant competent authority will also change. Firms may want some assurances that they will not be sanctioned for reporting to the wrong competent authority if there is a change.

ESMA may consider publishing a list of the relevant competent authorities, which firms could rely on for a period of time (e.g. one or two years) and which would be updated by ESMA. EFET also notes that energy traders may need to capture business where a significant portion of the market is off exchange, i.e. OTC swap market.

Q538: What alternative structures or solutions are possible to meet the obligations under Article 58 to identify the positions of end clients? What are the advantages or disadvantages of these structures?

EFET agrees with ESMA's proposal that the determination of the central competent authority to which position reports are made should be decided solely by the volume of activity undertaken on exchanges does not take into account that the level of activity is likely to change from time to time, meaning that the relevant competent authority will also change. Firms may want some assurances that they will not be sanctioned for reporting to the wrong competent authority if there is a change.

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Q539: Do you agree with ESMA’s proposal that only volumes traded on-exchange should be used to determine the central competent authority to which reports are made? If you do not agree, what alternative structure may be used to determine the destination of position reports?

EFET agrees with ESMA's proposal that the determination of the central competent authority to which position reports are made should be decided solely by the volume of activity undertaken on exchanges does not take into account that the level of activity is likely to change from time to time, meaning that the relevant competent authority will also change. Firms may want some assurances that they will not be sanctioned for reporting to the wrong competent authority if there is a change.

ESMA may consider publishing a list of the relevant competent authorities, which firms could rely on for a period of time (e.g. one or two years) and which would be updated by ESMA. EFET also notes that energy traders may need to capture business where a significant portion of the market is off exchange, i.e. OTC swap market.

EFET European Federation of Energy Traders

Q540: Do you agree that position reporting requirements should seek to use reporting formats from other market or regulatory initiatives? If not mentioned above, what formats and initiatives should ESMA consider?

Yes, EFET agrees that position reporting should seek to use reporting formats for other regulations and in particular those that are in place or being considered for EMIR trade reporting or for transaction reporting under MiFIR.

EFET further recommends that any reporting requirements and data standards that are adopted be compatible with analogous requirements imposed by other jurisdictions. Differing data standards will require market participants to develop duplicative systems. This would be costly and inefficient. Moreover, inconsistent data standards increase the risk that regulators will receive and make policy decisions based on inconsistent market information. EFET therefore calls, amongst other things, for consideration of the formats used for position reporting in other jurisdictions in order to facilitate both implementation and accuracy of reporting.

Q541: Do you agree that ESMA should require reference data from trading venues and investment firms on commodity derivatives, emission allowances, and derivatives thereof in order to increase the efficiency of trade reporting?

Yes, EFET agrees that to support the position reporting trading venues should be required to provide reference data on on-venue and economically equivalent OTC contracts. EFET recognises the product identification under EMIR may not be granular enough in the specific context of position reporting of commodity derivatives for the purpose of position limits under MiFID II. EFET also recognises that product identification under EMIR does not incorporate the concept of linking position in on-venue contracts with 'economically equivalent OTC contracts'.

Q542: What is your view on the use of existing elements of the market infrastructure for position reporting of both on-venue and economically equivalent OTC contracts? If you have any comments on how firms and trading venues may efficiently create a reporting infrastructure, please give details in your explanation.

EFET believes that Trade Repositories should have a primary role because this would allow investment firms, members or participants of regulated markets, MTFs and OTFs to leverage on existing processes and infrastructures. EFET believes that ESMA should consider the minimisation of costs for the entire system as a primary goal when establishing rules on position reporting.

EFET believes that CCPs are best placed to report position data on OTC cleared trades however currently some data fields such as the client identifier will be missing. Trading venues should be able to report positions either to NCAs or Trade Repositories for on-exchange contracts.

Q543: For what reasons may it be appropriate to require the reporting of option positions on a delta-equivalent basis? If an additional requirement to report delta-equivalent positions is established, how should the relevant delta value be determined?

Reporting of delta equivalent positions should be established on the basis of market participants' models and not be restricted by pre-defined number published by trading venues.

EFET does not think that the preferred methodology for calculation of delta-equivalent futures position should require use of the delta value published by trading venues. Instead EFET thinks participants should be able to use their own internal models / delta calculations to ensure consistency with internal records and risk systems (subject to being able to justify the calculation).

Q544: Does the proposed set of data fields capture all necessary information to meet the requirements of Article 58(1)(b) MiFID II? If not, do you have any proposals for amendments, deletions or additional data fields to add the list above?

EFET believes that these data fields should be integrated in the current EMIR reporting and TRs should be given the task to calculate open positions for market participants.

Gap analysis should be conducted against existing reporting formats applicable to market participants. In particular, EFET recommends consideration of EMIR reporting formats and the CFTC's position reports, and new ownership and control reporting rules. This will ensure consistency and therefore reduction in differences in further formats.

Q545: Are there any other fields that should be included in the Commitment of Traders Report published each week by trading venues other than those shown above?

While recognising the need for the reporting fields to be specifically applicable to, and take account of, the idiosyncrasies of the European market framework and regulatory regime, both market participants and market infrastructures strongly support alignment with CFTC standards (including Commitment of Trader reports) wherever possible so as to promote consistency of reporting for all market participants with operations outside the EU (and, in particular, those active in the US).

9. Post-trading issues

9.1. Obligation to clear derivatives traded on regulated markets and timing of acceptance for clearing (STP)

Q605: What are your views generally on (1) the systems, procedures, arrangements supporting the flow of information to the CCP, (2) the operational process that should be in place to perform the transfer of margins, (3) the relevant parties involved these processes and the time required for each of the steps?

1) CCP must offer straight through processing which limits the timeframe between trade execution, registration to and acceptance for clearing. Based on existing venues, a registration by the brokers that can be viewed/accepted by the trader and the clearer offers the most secured environment and the less error rates;

(2) Using existing process between CCP and CM and then up to CM to decide on the credit risk they are taking over for their clients i.e. collection of margin on the business day following clearing (as usual or asking for intraday margins);

(3) Parties involved are the Exchange (registration platform), CCP (position allocation and margin calculation), Trader and Broker (registration) and the Clearing Member. The timeline between execution and acceptance for clearing should always be within 24 hours, if not feasible on same business day than execution.

Q606: In particular, who are currently responsible, in the ETD and OTC context, for obtaining the information required for clearing and for submitting the transaction to a CCP for clearing? Do you consider that anything should be changed in this respect? What are the current timeframes, in the ETD and OTC context, between the conclusion of the contract and the exchange of information required for clearing on one hand and on the other hand between the exchange of information and the submission of the transaction to the CPP?

The CCP needs to obtain the information and in the existing process, it mainly depends on the technology and rules of the different CCP. There is a lack of process harmonisation between the different CCP:

- System where transactions are executed over a Broker, the best process is where the Broker registers both sides of the transactions for a perfect matching. However, the Trader must be in a position to check the validity of the transaction vs. trade order before the trade is cleared.

- System where the different parties of the trade can register the trade (broker, trader or execution desk of the clearer) are much less efficient because the registration for clearing is validated first when all parties have confirmed the transaction. This often leads to delays of hours when not business days between execution and acceptance for clearing.

- In most cases execution and acceptance for clearing happen within the same business day, and delays are rarely greater than 1 or 2 business days.

- Over the last years, organisation like EFETnet with eXRP have developed technologies to secure and follow-up on workflow between execution and registration for clearing as well as for reducing process the timeframe through modern matching technologies.

- However due to the wider range of products offered for clearing and the level of complexity of commodities of certain products e.g. freight, STP are not implemented everywhere and some OTC Clearing processes are still very manual.

Q607: What are your views on the balance of these risks against the benefits of STP for the derivatives market and on the manner to mitigate such risks at the different levels of the clearing chain?

STP does not necessarily generate higher risks due to shorter timeframe for CCP and CM to take decisions. In the existing clearing models, CM are nearly always in a position to pre-fund for their clients, due to shifted deadlines between CCP requirements towards CM and CM towards their clients, especially when the CM's client is a corporate and limited in time for instructing margin payments for same value date.

With regards to credit limits, STP process may however create risk by a lack of validation of the transaction whose exposure is within the credit limit between CCP and CME and between CM and his client i.e. neither the Clearer nor the Trader has a chance to validate transactions registered (maybe erroneously) by an execution Broker.

The pre-funding risk is mainly covering the daily variation margin and is secured by initial margin as initial margin is calculated to cover default payments of Variation margin for 1 or 2 days, depending on CCPS' models.

Q608: When does the CM assume the responsibility of the transactions? At the time when the CCP accepts the transaction or at a different moment in time?

There again, it depends mainly on the CCPs rules. In most of the cases, as soon as a transaction is accepted for clearing, the CM becomes the CP of the CCP, and at the same time the CM becomes the CP of his client.

Q609: What are your views on how practicable it would be for CM to validate the transaction before their submission to the CCP? What would the CM require for this purpose and the timeframe required? How would this validation process fit with STP?

In certain clearing models, the CM is part of the clearing validation, but the process is not the same throughout all CCPs models.

Q610: What are your views on the manner to determine the timeframe for (1) the exchange of information required for clearing, (2) the submission of a transaction to the CCP, and the constraints and requirements to consider for parties involved in both the ETD and OTC contexts?

1) Depends on the technology of the Venue to submit trade date to the buyer, the seller and the CCP.

(2) Should take place within the hour following the execution.

(3) The same technologies in place for ETD should be used for OTC Clearing and certain venue e.g. EEX/ECC already offer it.

Q611: What are your views on the systems, procedures, arrangements and timeframe for (1) the submission of a transaction to the CCP and (2) the acceptance or rejection of a transaction by the CCP in view of the operational process required for a strong product validation in the context of ETD and OTC? How should it compare with the current process and timeframe? Does the current practice envisage a product validation?

(1) In the current environment, OTC contracts eligible for clearing follow the same approval process like ETD regarding the introduction of new products i.e. all execution, registration and clearing processes must be in place with the CCP and the CM, before any transaction can be registered for clearing. Depending on the complexity of the product which is very variable in commodity business it can take several weeks or months

(2) The criteria for rejecting a transaction for clearing must be clearly defined in the CCP rules. Nearly all current process require deal validations form CCP, but not always from the Clearer or his Client.

Q613: What are your views on the treatment of rejected transactions for transactions subject to the clearing requirement and those cleared on a voluntary basis? Do you agree that the framework should be set in advance?

EFET agrees that the framework for rejected transactions should be set in advance, because this framework is completely missing in the current environment. Maybe there could be an optionality to cancel or accept an OTC transaction with agreed rules in the case of a diverging instructions form the two parties of the transactions (cancelling or OTC).

9.2. Indirect Clearing Arrangements

Q614: Is there any reason for ESMA to adopt a different approach (1) from the one under EMIR, (2) for OTC and ETD? If so, please explain your reasons.

EFET does not see any reason for ESMA to adopt a different approach for EMIR and MiFIR, although the wording is not 100% identical. EMIR RTS 149/2913 Chapter 2 already describe indirect clearing structures rather than processes how to become indirect client. Therefore EFET considers those descriptions being fit for purpose of meeting the requirements of “establishing indirect clearing arrangements” as well as of being “permissible”.

The same applies for OTC and ETD. Once put in the clearing process there is no need to treat those products differently in respect of indirect clearing arrangements.

However, EFET is a bit concerned already regarding the EMIR RTS about ensuring that those arrangements shall not increase counterparty risk. As long as the Indirect Client is not granted direct claim against the Clearing Member (in case of a client default) and against the CPP (in case of simultaneous Clearing Member and Client default – such scenario not to be considered to be too remote as often Clearing Member and Client are affiliated in such structures) the counterparty risk for the Indirect Client increases with the addition of each intermediary as the liability of the client to the Indirect Client will always be limited to the rights it has against the Clearing Member (and maybe against the CCP) on the other side of the contractual chain. In some cases liability is even limited to claims that have been successfully enforced against CM and/or CCP.

EFET Reply to ESMA MiFID II/ MiFIR Consultation Paper

1. Micro-structural issues

1.1. Algorithmic and high frequency trading (HFT)

Q167: Which would be your preferred option? Why?

EFET thinks that Option 1 (Definition is based on a set of explicit requirements) is the best way to define HFT. The definition of Option 1 is more explicit (e.g. 2 messages per second) and will therefore provide a clear landmark to the counterparties (where HFT will definitely begin). From a firm's perspective, Option 2 (Definition based on a floating assessment of counterparties) is not precise/explicit enough and therefore could cause problems in the long run.

Q171: Do you agree with the above assessment? If not, please elaborate.

EFET does not agree that if a member's strategy falls under the definition of HFT in one trading venue by using one trading ID that has been identified as performing high frequency trading technique, that then the entire member (i.e., firms) should be considered entirely as subject to MiFID II provisions across the EU and all trading venues. Each trading activity should be treated separately w.r.t the member/participant classification (to prevent unnecessary effort) and ESMA should allow firms to ring-fence identified high frequency activities so that only the respective activity is subject to the requirements imposed on that activity.

2. Commodity derivatives

2.1. Financial instruments definition - specifying Section C 6, 7 and 10 of Annex I of MiFID II

Q213: Do you agree with ESMA's approach on specifying contracts that "must" be physically settled and contracts that "can" be physically settled?

EFET generally agrees with the approach proposed by ESMA. However, EFET would like to clarify that the distinction between 'can' and 'must' be physically settled may be difficult to assess upon entry into a contract for those wholesale energy products and energy derivatives that are eventually settled physically where transfer of ownership takes place upon execution.

In any case the understanding of EFET is that:

- Where contracts must be settled in cash or have an option to be settled in cash at the option of one of the parties, these should be assessed under C.5;

- Only contracts without (option for) cash settlement that ‘can be’ or ‘must be’ physically settled need to be assessed under C.6 or C.7, depending on the place of execution and the other conditions set out in these sections. However when cash settlement takes place ‘by reason of default or other termination events’, this should not give reason to any assessment under Annex I Section C, as this is merely an exception to the normal settlement of the contract. The wording in C5 and the spirit of C6 and C7 confirm this understanding.

- A commodity derivative contract that is cash-settled by mutual consent must explicitly contain provisions for cash-settlement by mutual agreement. In the experience of EFET this does not happen very frequently. In any case it is most likely that if mutual agreement between the parties to cash settle is reached, this would result in the contract being categorised as falling under section C.5

In legal terms, primary and secondary contractual obligations have to be distinguished. A contract is classified as a derivative financial instrument within the meaning of C.5, if a party has the primary contractual right to cash settle or opt for a cash settlement. In contrast, if cash settlement takes place because of early termination or because of an event of default, the compensation for damages is a secondary obligation which replaces the primary obligation.

In relation to the draft technical advice, EFET understands from the ‘waterfall’ of definitions in a way that contracts which are excluded from the definition of financial instruments under Annex I Section C.6 (must be physically settled wholesale energy products and traded on a OTF), are not be required to be tested further against the criteria defined in C.7 and the related implementing rules. The wording "not otherwise mentioned in point 6" included in C.7 highlights that C.6 prevails over C.7 in this regards. Similarly, EFET expects that the transitional exemption for energy derivatives in coal and oil according to article 95 is valid also for those contracts that must be physically settled and that are traded bilaterally.

The carve-out in C.6 for wholesale energy products would be deprived of their purpose if the same contracts would have to be assessed against the requirements of C.7.

Q214: Which oil products in your view should be caught by the definition of C6 energy derivatives contracts and therefore be within the scope of the exemption? Please give reasons for your view stating, in particular, any practical repercussions of including or excluding products from the scope.

The Directive 2014/65/EU does not restrict the definition of oil products to a subset of contracts. Thus, the term ‘oil’ should encompass crude oils, any other refinery feedstocks, as well as all grades of refined petroleum and related products traded in the commodity markets including liquefied petroleum gas, fuel oil, middle distillates, gas to liquids fuels, jet, kerosene, avgas, mo.gas. (or motor gasoline), biofuels, base oils, chemical feedstocks and chemicals. EFET would suggest the following definition: 'mineral oil, of any description and petroleum gases, whether in liquid or vapour form, including products, components and derivatives of oil and oil transport fuels'. Such a definition of oil would be consistent with the rationale expressed in other sections of the Consultation/Discussion Papers, e.g. ancillary activity section, which do not disaggregate the 'oil' asset class. In addition, this approach and definition would be in line with national legislation, such as the UK FCA Handbook and the 2008 Glossary Amendment Instrument which include bio-fuels within the scope of 'oil market activity'. It will be important, too, that oil transportation fuels, relating to oil including biofuels, are included in the definition, considering that biofuels are a mandated component of gasoline and diesel.

If the products, components and derivatives of oil and transportation fuels are excluded from the scope of C.6 energy derivative contracts, there are likely to be significant additional cost and liquidity implications for these markets and for end consumers. This is because many firms would have to clear this physical business and pay a significant resulting daily risk margin (initial and variation). This would reduce working capital for commercial and industrial activities.

In addition, EFET notes that the hedging exemption provided by the European Market Infrastructure Regulation (EMIR) to non-financial counterparties (NFCs) would not solve the problem as it applies to the calculation of the threshold (used to identify NFC+), but not to the clearing obligation when this is triggered. Participants who are NFC+ by virtue of other activities would still have to clear or margin all derivative transactions.

If these oil derivates products are not excluded or are included on a restricted basis of interpretation, the regulatory burden on trading energy commodities would significantly increase discouraging market participation and depressing liquidity.

Q215: Do you agree with ESMA's approach on specifying contracts that must be physically settled?

Yes, in general EFET agrees with the approach proposed by ESMA. However, the wording proposed by ESMA does not acknowledge fully the obligation for physical settlement applicable under standard contracts, nor does it reflect the concepts expressed in Recital 10 of MiFID II, which defines the conditions of an enforceable and binding obligation for physical delivery. EFET offers some drafting suggestions at the end of this answer.

Firstly, the terms 'unrestricted and unconditional right to physical delivery' may create legal uncertainty. According to Recital 10 of MiFID II mentioned by ESMA (point 11, p.279 CP), the contracts must have an ‘enforceable and binding obligation to physically deliver which cannot be unwound’. This must be understood to uphold that an enforceable and binding obligation of physical delivery is a rule which allows for certain exceptions, but excludes an option to pay or receive cash instead of fulfilling the obligation to physically deliver. The terms used in the Recital are more appropriate from a legal point of view more closely in line with the level I text compared with the proposals of the draft technical advice.

Moreover, exceptions should be made clear in case of default and termination events, including the right to pay financial compensation for an event of default. The draft technical advice should clearly state that default provisions are to not be understood as an option for one party to replace physical delivery with cash settlement. In civil law a cash payment obligation as compensation for damage caused by a failure to deliver or accept the relevant commodity is considered as a damage compensation payment and not a cash settlement – and merely as a secondary obligation as opposed to a primary obligation of physical settlement agreed in the contract. It would be inconsistent to apply a different standard in the implementing rules for C.6 (and C.7) which define physically settled commodity derivative financial instruments.

Most importantly, whilst EFET appreciates ESMA’s consideration of the implications of ‘operational netting’ in power and gas markets, our association highlights that the offset of deliveries for operational reasons in the gas and electricity markets is normally an obligation stemming from the transmission systems operators’ operational rules and it should not be understood to be a ‘right to offset transactions’. Similarly the right to net payments obligations should be acknowledged without compromising the status of the contract as ‘must be physically settled’.

In consideration of the comments above, EFET suggests the following amendments to the draft technical advice:

1. In accordance with Article 4.2(a) of Directive 2014/65/EU, a contract shall be considered as ‘must be physically’ settled if it satisfies the following conditions:

i.it establishes the enforceable and binding obligation to physically deliver the commodity;

ii. it does not include a right to cash settle or to offset transactions, except in the case of force majeure, default or any other contractually agreed termination event;

2. The existence of force majeure provisions does not prevent a contract from being characterised as “must be physically settled”

3. The existence of other bona fide clauses rendering it impossible to perform the contract on a physical settlement basis does not prevent a contract from being characterised as “must be physically settled”

3a. The offset of deliveries for operational reasons or a right to net payments are not to be considered a right to offset transactions within the meaning of paragraph (1)(ii).

4. For the purpose of Section C.6 and C.7 of Annex I to Directive 2014/65/EU contracts that are physically settled including but not limited to the following delivery methods:

i. physical delivery of the commodities;

ii. a transfer of title of the commodities, including the delivery of a document giving rights of an ownership nature to the relevant commodities or the relevant quantity of the commodities concerned (such as a bill of lading or a warehouse warrant); or

iii. any other method of transferring the title to the commodities or rights of an ownership nature in relation to the relevant quantity of the commodities including notification, scheduling or nomination to the operator of an energy supply network, that entitles the recipient to the relevant quantity of the commodities.

[to be added to the definitions and subject to further refinements] 'Offset of deliveries': means the obligation of counterparties to a physical trading agreement to submit net nominations and/or schedules to the system operators of the facility at which the title of ownership is transferred in accordance with the rules and guidelines of operations of such system operators

These amendments are suggested to ensure that the terms used are appropriate and provide sufficient legal certainty and consistency.

Q216: How do operational netting arrangements in power and gas markets work in practice? Please describe such arrangements in detail. In particular, please describe the type and timing of the actions taken by the various parties in the process, and the discretion over those actions that the parties have.

EFET is delighted that ESMA acknowledges that operational netting in power and gas markets is distinct from cash settlement. EFET also agrees that neither operational netting, nor obligations to submit net schedules should cause a contract to be excluded from the definition of 'must be physically settled'.

Physically settled gas and electricity transactions involve the delivery of the underlying commodity and the change in the ownership of the commodity. These contracts include spot products (where delivery occurs within a short time period) and forward contracts (for delivery at some point in the future).

The operational arrangements for delivery in gas and power markets may produce an offset of physical deliveries. However no netting takes place between contracts or transactions which could be considered equivalent to cash settlement: as the obligation under each individual contract to physically deliver and transfer title remains legally binding and enforceable. In this and the next answers the terms nomination and scheduling are used as synonymous.

Nominations/Schedules timelines to TSOs

In gas and power markets, participants have to enter into contractual arrangements with system operators of transportation pipelines/transmission lines in order to become network/system users and be able to deliver the energy produced or acquired to wholesale counterparties or retail consumers. Network codes, General Terms & Conditions of Transport/Transmission and the technical annexes are the main contractual and operational documents regulating the relationship between network/ users (or market participants) and the Transmission System Operators or (or TSOs).

Users may have direct access to energy production facilities (e.g. a power plant) or may acquire energy from other users. In all cases, the acquisition (and sale) of energy at a wholesale level takes place through contractual agreements (e.g. EFET master agreements) which stipulate the obligation for the selling party to a transaction to physically deliver and transfer the rights of title in the respective commodity and the obligation of the buying party to accept such delivery and transfer of title, including on a net basis (see for example EFET General Agreement concerning the delivery and acceptance of Natural Gas §4). Such a stipulation can also arise by virtue of the market structure itself.

A user must notify the TSO of how much energy it intends to deliver or accept at each entry and exit point to the system in each time unit (day or hour) and from whom it will receive or to whom it will deliver the energy at such a point (a unique identification code for each user must be provided for this purpose). Generally TSOs require an initial nomination or schedule to be made by the user on the day before delivery and, depending on the system, these nominations or schedules can be updated throughout the relevant day of delivery (renominations), up to the hour before delivery in most energy markets.

A user may buy and/or sell energy for delivery on a specific day or hour at a specific delivery point on numerous occasions with different counterparties in the time before the actual delivery takes place, depending on the portfolio of its commercial activities (e.g. production of energy, sales of energy) and a series of factors (e.g. weather forecast, price forecasts, availability of infrastructures etc.). Therefore, depending on their trading patterns, two users may end up with more than one trade between them at a particular delivery point for a delivery period and these may include both ”buys” and ”sells”. TSOs or service providers, who are responsible for the management and secure operations of the transportation networks on a physical and commercial point of view, process the information received and match the schedules submitted by each counterparty also to ensure that the instructions of sellers and buyers are consistent in order to take into account the flows required by each network user (or group of network users). Any inconsistency must be rectified before the delivery period occurs.

Some TSOs (for example National Grid Gas in the UK) simply require each pair of users to give them notice (by nominating) of every trade between them and the TSO will then aggregate the trades and set the buys off against the sells (if applicable) to produce a net position for the pair for each delivery period and delivery point. Other TSOs, for reasons of administrative convenience only, require the users to calculate the net position and to nominate or schedule such a net number to them.

It must be noted that failure by a user to nominate or schedule correctly and in time to a TSO constitutes a default under the trading contact as it will lead to incorrect quantities of energy being delivered and consequently damages being payable to the counterparty. This may also lead to imbalances in the energy system (see below).

As a result, in gas and power markets delivery is performed by submitting the nominations of the injections into/withdrawals from the energy system and the transactions with other wholesale counterparties to the operator of the designated delivery point.

An example on how nominations works in electricity markets can be found at this link, referring to the Belgian electricity system:
http://www.elia.be/~/media/files/Elia/Products-and-services/ProductSheets/E-Evenwicht/E3_E_E-Nomination.pdf

For Gas for example:
http://www.grtgaz.com/fileadmin/clients/fournisseurs/documents/en/operationnel/1_Find_out_more_about_nominations_confirmations.pdf

(http://www.grtgaz.com/en/acces-direct/customer/shipper-trader/peg.html#tabs3)

For completeness EFET would like to provide some background information on how the framework for balancing supply and demand in gas and electricity markets as this is an essential element of liberalised markets.

Balancing of demand and supply in gas and electricity markets

In the daily activity of submitting nominations/schedules to system operators all individual contracts traded either on platforms or bilaterally are physical for settlement purposes.

It is important to note that in addition to bilateral contractual obligations to other market parties, users of the gas and electricity systems are obliged or incentivised to "balance" their inputs to and outputs from the transmission system in each hour or day, otherwise the TSO will levy penalties on them. This is a fundamental operational principal of the modern European energy systems.

In the period following the actual flows (a few days or months), the TSOs calculate the energy inputs and outputs attributable to each network user for each relevant period. Differences between the final nominations and the actual intakes/offtakes are charged at a specific ‘balancing price’, usually structured in a way to incentivise network users to stay ‘in balance’ during each period. This ensures that the inputs and outputs of the system are commercially and physically balanced.

It is important to note that nominations and schedules are simply users’ intended deliveries and acceptances. What is actually delivered/accepted is what is allocated by the TSO after the delivery period. If more or less energy is physically transferred at a delivery point than the aggregate confirmed nominations of all users, then the resulting excess or shortage of energy is either attribute to the party causing the problem, if this can be identified or smeared across all users according to system rules (e.g. on a pro rata basis to nominations) as part of the TSO's allocation process. Users may under or over deliver or accept on their contractual obligations and the remedies clause of the relevant bilateral deal between them will then apply.

For instance, the EFET contracts contains terms that apply in the case of more than one trade between the parties at a delivery point in a delivery period to apportion the Allocated (i.e. delivered) quantity notified by the TSO for the delivery point and delivered period between the trades. This is important as it allows the parties to check that they have delivered and accepted the correct delivery quantity for each trade and, if not, to apply the damages/remedies clauses for failure to deliver or accept a trade, as well as to invoice for the amounts delivered under each trade.

Conclusion

The most relevant aspect is that operational arrangements do not involve the netting of contracts or transactions which remain separate and provide title transfer. Physical settlement is legally binding and enforceable. The offset of deliveries is merely the result of Nominations/Schedules submitted to TSOs according to their instructions and operational rules. Netting arrangements based on essential operational activities must be acknowledged and remain outside of the scope of derivative financial instruments. Indeed:

- The submission of nominations according to the operational rules provided by system operators is the way in which counterparties perform the obligation to settle physically their contracts.

- Conversely, contracts that are not for physical settlement do not require entering into contractual arrangements with system operators, do not require the submission of schedules nominations and are not subject to balancing rules.

These are significant elements. Failure to recognise operational netting practices as a means of physical delivery within ‘must’ be physically settled contracts would render the exclusion for physically settled wholesale energy products traded on an OTF, as defined in level 1, void.

Therefore, EFET urges ESMA to consider such substantial characteristics when compiling the draft technical advice to the EU Commission for the delegated acts on the definition of commodity derivative.

Q217: Please provide concrete examples of contracts that must be physically settled for power, natural gas, coal and oil. Please describe the contracts in detail and identify on which plat-forms they are traded at the moment.

Power and natural gas

Bilateral trading standard agreements in gas and electricity include contracts such as:

- The EFET General Agreements concerning the Delivery and Acceptance of Natural Gas / Electricity, including their annexes and appendices;
- Trading Terms & Conditions Short Term Flat NBP 1997 (NBP 1997, UK Gas);
- Zeebrugge Hub Natural Gas Trading Terms & Conditions (ZBT 2004, Belgian Gas);
- Grid Trade Master Agreement 2004 (GTMA 2004, UK Power);
- Standard Terms and Conditions for Sale and Purchase of Natural Gas for UK Short Term Deliveries at the Beach (Beach 2000, UK Gas);
- ISDA Master Agreement (1992/2002) with physical trading annexes (GTMA Transactions; NBP; ZBT);
- Any long form confirmation referring to the above mentioned master agreements.

These are examples of standard contracts for physical delivery used by parties that are trading bilaterally, including when trading through brokers. These Master Agreements stipulate the primary obligation for the selling party to a forward transaction to physically deliver and transfer the title in the respective commodity and the obligation of the buying party to accept such delivery and transfer of title.

Fulfilling such an obligation of delivery requires that the counterparties to a transaction have a separate contractual relationship with operators of transmission systems or transportation networks and/or service providers responsible for the management and operations of the nomination platforms. Delivery is arranged by submitting the schedules of the transactions to the operator of the designated delivery point.

Key terms of the Trading Contracts

- Obligation under each trade to physically deliver and transfer rights of title in the agreed quantity of the relevant commodity by the means applicable at the relevant delivery point. In order to deliver or accept the parties are obliged to nominate/schedule accurately and on a timely basis. There is no ‘cash out’ or ‘book out’ option whereby a party can elect to pay cash or liquidated damages to the other party in lieu of fulfilling its obligations to deliver or accept a commodity. Remedies for failure to deliver or accept the correct contract quantity in each delivery period for each trade – generally calculated as the difference between the contract price and the price paid or received by the non-defaulting party in replacing short positions or selling long positions caused by the defaulting party.

- Force majeure – generally defined as an occurrence beyond the reasonable control of one of the parties which it could not reasonably have avoided or overcome and which makes it impossible for one of the parties to perform its obligations according to the contract terms.

- In a natural gas contract, what happens in the event that Off Specification natural gas is delivered.

- Invoicing and payment – the quantities delivered under each trade are separately invoiced on a monthly in arrears basis and VAT paid (or the reverse charge applied) to such amounts.

- Credit and security requirements.

- Termination rights – The Framework Agreement and the Individual Contracts can only be terminated ordinary or early in the event of specified material reasons. An ordinary termination does not affect the existing Individual Contracts and the existing delivery obligation. In the case of material default such as accrued failures to pay, the insolvency of the counterparty or the failure of credit support, the non-defaulting party generally seeks to have the right to terminate all outstanding trades and to claim damages for both quantities already delivered but not paid for and its future losses arising from losing the contract early i.e. for its loss of bargain (Mark to Market losses). In practice these clauses are usually only invoked on the insolvency of the counterparty and whether they are enforceable depends on the insolvency laws of the country of incorporation of the party that is insolvent (NB: the laws of many countries prevent the termination of contracts on the grounds of insolvency). Contracts often provide an intermediate right for the non-defaulting party to suspend deliveries in the event of material default by the other party before invoking termination rights. If all trades are so terminated, the non-defaulting party must calculate its losses or gains in respect of each trade and aggregate and offset these, i.e. it cannot just claim for its losses whilst benefiting from its gains.

Some of these master agreements may provide for an option to elect early termination without a notice requirement (Automatic Termination), usually in case of insolvency or similar conditions endangering the claims of a party, in which the EFET General Agreement itself and all Individual Contracts terminate automatically at a pre-defined point in time if automatic early termination has been elected in the

Election Sheet. The background of the Automatic Termination is the different national legislation on insolvency with respect to close out netting as explained above.

Trades can be entered into bilaterally by means of the parties contacting each other (i.e. without the intermediation of a broker) or via brokers by voice/screen services (e.g. Prebon, Spectron). Even if trades are entered into via a broker, the parties to the trade are the buyer and the seller who must have access to and the ability to move physical energy to or from the relevant delivery point. The broker merely matches the two parties up and has nothing to do with physical delivery. Our current understanding is that energy brokers may classify as Organised Trading Facilities according to MiFID II.

The standard trading agreements mentioned in this answer are not available to non-sophisticated counterparties or to trading of non-standard/ non-liquid physical products (such as trading of gas directly from production wells, for example). Any non-standard energy trading agreement entered into bilaterally between two counterparties, which reflects terms similar or equivalent to those key terms listed above and provides for a binding primary obligation to physically delivery, should also be considered as a “contract that must be physically settled” within the meaning of C.6.

Finally, consideration should be given to those contracts in gas and electricity that must be physically settled and are concluded through an OTF (located in the EU) and whose delivery takes place outside of the EU, especially within Europe. In fact, such contracts are not strictly wholesale energy products i.e. ‘contracts for the supply of electricity or natural gas where deliver is in the Union’ (Article 2.4, Regulation 1227/2011/EC). However, it would be illogical to include them into the definition of derivative financial instrument.

Oil, oil products and coal

The vast majority of transactions in the physical oil markets are concluded on a bespoke basis between the parties incorporating seller’s General Terms & Conditions (GT&Cs) appropriate to the transaction structure in question (i.e. FOB/CIF/DES). Examples of such GT&C’s include those produced by Shell and BP, which are widely used in the industry. The parties have the obligation to make and receive physical delivery of the commodity at the specified location in the absence of an event of force majeure or other event of default giving rise to the normal contractual remedies and with no unilateral right for either party to replace its physical performance obligations with a cash settlement. In liquid markets where ‘chains’ of sales occur for operational convenience (i.e. X sells to Y which on-sells to Z) delivery of the physical cargo will be made directly to the location of the ultimate buyer in the chain, but the obligation to deliver and receive the commodity as well as the documents of title (i.e. bills of lading) are nevertheless transferred from each party to the next in the chain of linked sales and purchases.

Such contracts may be traded on the Platts e-Window and through the support of energy brokers which do not have the characteristics of multilateral trading facilities, e.g. via voice brokering. Such contracts may also be traded bilaterally.

The North Sea Brent, Forties, Oseberg Ekofisk (BFOE) traded crude oil market trades full cargo crude oil contracts on a forward basis. Forward full BFOE cargoes are physical trades and in the normal course will be placed into a nominated cargo chain with obligation for physical delivery and acceptance in the relevant terminal delivery programme. Where a chain of sale and purchases in relation to a full cargo BFOE delivery involves two or more of the same parties at different stages of the chain, the parties may enter into a subsequent and separate agreement and book out their obligations on the basis of net payment. Such agreement would be assessed according to the relevant applicable definitions.

These arrangements are necessary for the efficient operation of the North Sea physical crude markets. It is important that regulation construes them properly to ensure the status of the BFOE contract as a trading instrument for the delivery of physical cargoes of crude oil is preserved effectively. All BFOE Partials and Full Cargoes are governed by SUKO 90 15 Day Brent GTC’s with updated amendments (now 25 day Brent).

In case of Coal, the most used standard contract is the ‘Standard Coal Trading Agreement’ (SCoTA).

Q218: How do you understand and how would you describe the concepts of “force majeure” and “other bona fide inability to settle” in this context?

Force Majeure is generally defined as an occurrence beyond the reasonable control of one of the parties which it could not have reasonably avoided or overcome and which it makes impossible for one of the parties to perform its obligations according to the contract terms. Please note that this definition is subject to national civil laws and case law and might evolve subject to new legislation being adopted or case law being established. In case of liquid gas and electricity markets for example, depending on the delivery point, this may be limited to failure of communication or IT systems of the relevant network (within system balancing points) or an unplanned physical outages or failures of pipelines, terminals and transmission systems. In the case of the oil markets it may include a broad range of marine, port, pipeline or storage related events affecting the transmission and handling of cargoes of crude oil or refined products by sea and by pipeline.

In such circumstances, no breach, default, other termination event or other contractual event is deemed to have occurred and the counterparty claiming the Force Majeure is released from its contractual obligations for the period of time during which force majeure prevents its performance. In practice this means that the defaulting party is not required to pay the damages that would otherwise be payable for a failure to deliver or accept the correct contract quantity under a trade.

Force Majeure provisions are not be characterized as an option for one party to replace physical delivery with cash settlement. This also follows from C.5 which defines the cash settled commodity derivatives which qualify as financial instrument under MiFID II by including all derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties “other than by reason of default or other termination event”. It would be inconsistent to apply a deviating standard in the implementing rules for C.6 (and C.7) which require the assessment of physically settled contracts.

Other bona fide inabilities to perform should be understood, instead, as any circumstance whereby the performance of a physical delivery or off-take does not take place for reasons that do not qualify as Force Majeure or for reasons of default or another termination event and which are objectively measurable as reasons defined in the contract terms for parties not to perform their obligations and set the contract aside. These other bona fide inabilities to perform may include condition precedent clauses or other circumstances that may suspend – but not terminate – the execution of the contract, annihilate ab initio or void and set aside the contract.

Civil law and common law list a number of such reasons (e.g. because the essential conditions for the formation of an agreement are not met, because of duress, because of conditions precedent, because of novations) which are accommodated through contractual clauses which can be qualified as bona fide inabilities to perform.

In all these cases, the bona fide clauses which comply with the civil/common law rules of the formation of agreements do not change the nature of the contracts which are still to be considered as ‘must be physically settled’, because the related clauses are only intended to protect the counterparties in cases where the underlying governing law prescribes the contract to be set aside and circumstances thus do not allow the ordinary execution of the contract, i.e. delivery of the commodity.

Events of Default are objective circumstances designated in contracts as termination events, material reason, events of default or any other terms that may be chosen freely by the parties which may lead to the early termination of a physical trading agreement, thus excusing the delivery (and often providing for a secondary compensation obligation to step into the place of the primary unexecuted delivery obligation). These events of default or early termination events are consistently used in the industry agreements for the trading of physical commodities in Europe (whether these are standard master agreements, customised master agreements or non-standard trading agreements).

Therefore, in all the cases mentioned above and namely Force Majeure, bona fide inabilities to perform and events of default/other termination events the physical delivery may be excused without changing at all the nature of contracts that ‘must be physically settled’.

The examples mentioned in this answer should be intended only as illustrative and not exhaustive or conclusive because the main purpose of such concepts is to be sufficiently broad to accommodate unforeseen events impacting the commodity markets in question. Any attempt to define such cases in a granular way for all commodities would lead to additional legal uncertainty because the operational arrangements and practices in commodity markets differ extensively (see for instance the differences between the gas and oil markets referred to above).

In other words, it is impossible to provide a definitive list of reasons preventing the physical settlement of contracts as they can vary from case to case and similar outcomes for occasions of contractual non-completion may have fundamentally different drivers.

Q219: Do you agree that Article 38 of Regulation (EC) No 1287/2006 has worked well in practice and elements of it should be preserved? If not, which elements in your view require amendments?

Article 38 of Regulation No 1287/2006 has worked well as it has provided sufficient guidance to identify the objective characteristics of contracts falling under C.7 of Annex I, Section C of Directive 39/2004/EC. Therefore, EFET does not agree with most of the changes proposed in the draft technical advice as they may create confusion and legal uncertainty.

EFET believes that the standardisation criterion should be better specified and EFET suggests a reference to ‘listed contracts’ to limit an interpretation that can be otherwise subjective.

Also, EFET has some technical but substantial suggestions on the text of the technical advice that EFET urges ESMA to consider them:

- The wording ‘as far as contracts are within the scope of C.6’ does not seem to be technically appropriate, since contracts in the scope of C.6 are by definition not subject to C.7. Therefore, a general approach is preferable to include OTF-traded contracts and explicitly mentioning the exception.

- The case of third country venues performing similar functions to an OTF for wholesale energy contracts, should be treated similarly as under MiFID I.

In consideration of the comments above EFET suggests the following amendments:

5. For the purposes of Section C(7) of Annex I to Directive 2014/65/EU, a contract which is not:

- a spot contract within the meaning of paragraph [6],

- a contract for commercial purposes within the meaning of paragraph xx, or

- otherwise mentioned in section C(6) of Annex I to Directive 2014/65/EU (meaning carved out from the definition of financial instrument under the terms of C.6)

shall be considered as having the characteristics of other derivative financial instruments and not being for commercial purposes if it satisfies all the following conditions:

(a) it is standardised so that in particular the price, the lot, the delivery date, the product quality specifications of the underlying, the delivery location and other terms are determined by reference to regularly published prices of listed contracts, standard lots or standard delivery dates, standard product specifications, benchmark grades, or delivery locations and other standardised terms

(b) it is cleared by a clearing house or other entity carrying out the same functions as a central counterparty, or there are arrangements for the payment or provision of margin in relation to the contract;

(c) it meets one of the following sets of criteria:

i. it is traded on a third country trading venue that performs a similar function to a regulated market, an MTF or an OTF except for wholesale energy contracts or energy derivative contracts that must be physically settled and that are traded on an OTF or a third country trading venue that performs a similar function to an OTF;

ii. it is expressly stated to be traded on, or is subject to the rules of, a regulated market, an MTF, an OTF except for wholesale energy contracts or energy derivative contracts that must be physically settled and that are traded on an OTF or a third country trading venue that performs a similar function to an OTF; or

iii. it is equivalent to a contract traded on a regulated market, an MTF, an OTF except for wholesale energy contracts or energy derivative contracts that must be physically settled and that are traded on an OTF or a third country trading venue that performs a similar function to an OTF, with regards to the price, the lot, the delivery date and other terms including equivalent margining and netting treatment to contracts that are traded on a trading venue.

Q220: Do you agree that the definition of spot contract in paragraph 2 of Article 38 of Regulation (EC) 1287/2006 is still valid and should become part of the future implementing measures for MiFID II? If not, what changes would you propose?

Finally EFET would consider it valuable that a consultation/survey exercise with the industry is conducted at European level in order to identify a workable ‘spot’ definition for each commodity for any time beyond two trading days that reflects the market practice.

Also, in the context of the consultation, EFET suggests exploring the possibility to distinguish spot contracts from derivatives also based on other terms e.g. period at which the price of a contract refer. We remain available for a specific discussion on this topic.

Q221: Do you agree that the definition of a contract for commercial purposes in paragraph 4 of Article 38 of Regulation (EC) 1287/2006 is still valid and should become part of the future implementing measures for MiFID II? If not, what changes would you propose? What other contracts, in your view, should be listed among those to be considered for commercial purposes?

The definition of a contract for commercial purposes is valid but too narrow. ESMA should improve it in order to make the concept of 'commercial purpose' applicable in different contexts and for different commodities.

This need also results from ESMA's suggestion to remove both the reference to "commercial purpose" from the original article 38(1) and the reference to "characteristics of other derivative financial instruments" from article 38(4). Although this proposal is not explicitly commented on or explained, and EFET disagrees with it, one can deduce from it that ESMA has the intention of giving a different definition of "commercial purpose". Other than contracts entered into for the purpose of balancing the supplies and uses of energy, it should also include for instance contracts entered into for the purpose of meeting regulatory requirements, such as Compulsory Stock Obligations (CSOs) and the Renewable Transport Fuel Obligation (RTFO).

In this sense, EFET recommends that ESMA should take into consideration the approach adopted under the U.K. legislation. The legislation makes explicit provisions for indications to be used to evaluate whether a contract is made for commercial purposes, namely: (a) where one or more of the parties is a producer of the commodity or other property, or uses the commodity in its business; (b) the seller delivers or intends to deliver the commodity or the purchaser takes or intends to take delivery of it.

This type has worked well in practice at the national level and EFET strongly recommends that ESMA should adopt a similar approach, in order to avoid the circumstance in which - by giving a closed and specific list of contracts to be defined as having a commercial purpose - other contracts remain out of the definition without appropriate justification.

Further, EFET notes that paragraph 4 of Article 38 of Regulation (EC) 1287/2006 refers both to C.7 and to C.10. This is missing in the draft technical advice proposed by ESMA on the 'commercial purpose'.

It should be reinstate as it reflects the existing policy that contracts entered into for commercial purpose should also be regarded as not having the characteristics of other derivative financial instruments for the purposes of C.10 and, without evidence of any legislative intent to change this policy, should be carried forward into MiFID II.

A potential text that cover the cases mentioned above and applies also to C.10 contracts is the following:

“A contract shall be considered to be for commercial purposes for the purposes of Section C(7) of Annex I to Directive 2014/65/EU, and as not having the characteristics of other derivative financial instruments for the purposes of Sections C(7) and (10) of that Annex, if it is entered into:

1. with or by an operator or administrator of an energy transmission grid, energy balancing mechanism or pipeline network, and it is necessary to keep in balance the supplies and uses of energy at a given time;

2. for the purpose of meeting regulatory requirements to purchase, sell, hold or deliver a commodity;

3. where one or more of the parties is a producer of the commodity or other property, or uses it in his business; or

4. the seller delivers or intends to deliver the property or the purchaser takes or intends to take delivery of it.”

Q222: Do you agree that the future Delegated Act should not refer to clearing as a condition for determining whether an instrument qualifies as a commodity derivative under Section C 7 of Annex I?

No, EFET disagrees. The characteristic of contracts that are centrally cleared by CCPs or similarly margined bilaterally is a key characteristic. In fact, it is MiFID defining which contracts are classified as derivative financial instruments, whilst the clearing obligation under EMIR is only a consequence of such contracts being defined as financial instruments and will apply only to a subset of such contracts, after these have been determined to qualify as derivative financial instruments under MiFID. Hence the circularity mentioned in point 36 between the two pieces of legislation does not exist if the rules are implemented taking into account the hierarchy between MiFID, which prevails, and EMIR.

Q223: Do you agree that standardisation of a contract as expressed in Article 38(1) Letter c of Regulation (EC) No 1287/2006 remains an important indicator for classifying financial instruments and therefore should be maintained?

Standardisation of contract terms is common practice of market development. Efforts to enhance standardisation should be favoured because the use of standard terms reduces legal uncertainty independently from the fact that the contract may have the characteristics of other derivative financial instruments.

Furthermore, such a criterion should not be the only factor for deciding whether to consider all contracts that satisfy a certain level of standardisation as contracts not having the characteristics of other financial instruments. Also, other than standardisation in price, lot and delivery dates, commodity derivatives are characterised by standardised product specifications for the underlying commodity, or based on benchmark grades of product, to be delivered into pre-specified locations. EFET recommends ESMA to further specify such criterion in the draft technical advice.

Q224: Do you agree with the proposal to maintain the alternatives for trading contracts in Article 38(1)(a) of Regulation (EC) No 1287/2006 taking into account the emergence of the OTF as a MiFID trading venue in the future Delegated Act?

Yes, EFET agrees with the intention to maintain the alternatives and to take into account the introduction of OTFs. However, EFET disagrees with the proposed change to the third limb of the trading criterion from “expressly stated to be equivalent to” to “equivalent to”. The current test has worked well to date. The requirement for a contract to be "expressly stated to be equivalent to" a contract traded on a regulated venue provides clarity for all market participants, as it is possible to establish whether or not this criterion is met by looking at the terms of the contract.

Whilst EFET understands the ESMA comments, we do not consider that the ESMA proposal achieves a more objective test. A mere concept of ‘equivalence’ is likely to introduce legal uncertainty since it introduces a subjective test under which the parties may adopt different positions on whether a contract is “equivalent”. Implementing regulations should absolutely avoid situations in which counterparties are not able to know whether a contract is a derivative financial instrument or not.

If ESMA wants to avoid that the classification in this respect depends on the choices of the counterparties, EFET suggests either sticking to the previous wording: “expressly stated to be equivalent” or, alternatively, to provide a workable definition of equivalence, in ordering to avoid creating any regulatory uncertainty for market participants.

Also, EFET believes that to ensure consistency with the level 1 text, a specific and equivalent treatment should be provided for contracts that are traded or are expressly stated to be traded on a third country trading venue that performs a similar function to an OTF which must be physically settled, namely C.6 energy derivatives and wholesale energy products.

Moreover, EFET reiterates that central clearing or margining of contracts is a relevant and substantial condition to classify contracts which have the characteristics of other derivative financial instruments; if not included as per the suggestion of EFET on 5(b), the existence of clearing/margining arrangements must at least be taken into account when considering the equivalence criterion of 5(c)(iii).

Q225: Do you agree that the existing provision in Article 38(3) of Regulation (EC) No 1287/2006 for determining whether derivative contracts within the scope of Section C(10) of Annex I should be classified as financial instruments should be updated as necessary but overall be maintained? If not, which elements in your view require amendments?

Yes, EFET partially agrees with the proposal to maintain the text of article 38(3) or Regulation 1287/2006 broadly the same.

Firstly, EFET appreciates that ESMA acknowledges that the exclusion under C.6 applies to wholesale energy products, including both contracts for the supply and transportation of electricity or natural gas. Therefore EFET agrees with the suggestions to amend the implementing rules concerning C.10.

However, to ensure consistency with the level 1 text, a specific and equivalent treatment should be provided for contracts that are traded or are expressly stated to be traded on a third country trading venue that performs a similar function to an OTF and that must be physically settled, namely for contracts listed currently in article 38(4) that are energy derivatives or wholesale energy products. Also, some technical amendments are necessary.

EFET suggests, therefore, the following amendments:

1. For the purpose of Section C 10 of Annex I of Directive 2014/65/EU, a derivative contract relating to an underlying referred there into, shall be classified as having the characteristics of other derivative financial instruments if one of the following conditions is satisfied:

i. the contract is settled in cash or may be settled in cash at the option of one or more of the parties to the contract, other than by reason of default or other termination event;

ii. the contract is traded on:

a. a regulated market;

b. an MTF; or

c. an OTF except for wholesale energy contracts that must be physically settled and that are traded on an OTF

iii. the contract fulfils the conditions imposed for derivative contracts under Section C 7 of Annex I of Directive 2014/65/EU

Q226: Do you agree that the list of contracts in Article 39 of Regulation (EC) No 1287/2006 should be maintained? If not, which type of contracts should be added or which ones should be deleted?

Yes, EFET agrees.

Q227: What is your view with regard to adding as an additional type of derivative contract those relating to actuarial statistics?

EFET does not have a firm opinion on this, however EFET does not see the need for introducing such additional type of derivative contract in this context.

Q228: What do you understand by the terms "reason of default or other termination event" and how does this differ from "except in the case of force majeure, default or other bona fide inability to perform"?

The terms *'by reason of default or other termination event'* are generally open to interpretation. Although it may be argued that these requirements are restrictive in the sense that they do not include every termination event, a systematic, teleological and historic interpretation speaks in favour of understanding these terms in a way to include each and every termination event.

It should be noted that C.5 defines the cash settled commodity derivatives which qualify as financial instrument under MiFID II by including all derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties "other than by reason of default or other termination event". This is the case also for C.10, which defines the cash settled derivative contracts relating to climatic variables, freight rates or official economic statistics which qualify as financial instruments under MiFID II and alike definitions were already included in C.5 and C.10.

It must be noted also that a right to close-out-net in case of a termination does not at all change the nature of a physically settled derivative into a cash settled derivative if close-out netting, which results in a cash payment extinguishing all future physical delivery obligations, is only possible following termination of the agreement rather than as means to fulfil an obligation under an existing and valid agreement.

Hence, based on this interpretation, these terms should be understood differently from *force majeure and bona fide inability to perform* and should be categorised as being circumstances, which may lead to termination of the contracts. The meaning of *"reason of default or other termination event"* is equivalent in all terms to the meaning of *"default and early termination events",* in line with the amendment that we suggest on the draft technical advice to C.6. In fact, it would be inconsistent to apply a different standard in the implementing rules for C.6 and C.7 which define physically settled commodity derivative financial instruments.

In this context, the concept of force majeure should be intended as an occurrence beyond the reasonable control of one of the parties which it could not reasonably have avoided or overcome and which makes it impossible for one of the parties to perform according to the contract terms.

Default or termination events may be specific cases of inability to perform of one of the counterparties, which include cases like inadequate performance assurance, insolvency or credit support documentation that determines the inability to perform the contract (see also below). For instance, according to EFET General Agreements there is the possibility of termination for a material reason': a party may give the other party unilateral notice of early termination and in such a case all further payments and performance in respect of all Individual Contracts as well as the EFET General Agreement itself shall be released and all existing duties and obligations should be replaced by the obligation of one party to pay damages for non-fulfilment to the other party (i.e., as according to the aggregated and netted settlement amounts).

The EFET General Agreements define such a material reason as certain cases of non-performance, cross default and acceleration, winding-up, insolvency or attachment, failure to deliver or accept and representation of warranty (e.g. failure to deliver agreed guarantee or credit standard downgrading below a certain level).

Furthermore, to reduce the counterparty risk, the EFET General Agreements provide for an option to elect early termination without notice requirement, usually in case of insolvency or similar conditions endangering the claims of a party, in which all Individual Contracts as well as the EFET General Agreement itself terminate automatically at a pre-defined point in time if automatic early termination has been elected in the Election Sheet.

EFET provides further examples of events of default or early termination event here below. However, these examples should be intended only as illustrative and not exhaustive or conclusive, because the main purpose of such concepts is to remain sufficiently broad to accommodate unforeseen events. Any attempt to define these cases in a granular way for all commodities would lead to additional legal uncertainty.

Events of default/early termination events:

- Breach of Agreement/ non-performance. When a party breaches its obligations under the master agreement (other than failure to deliver). (see e.g. §10.5(a) of the EFET General Agreement for Electricity or Gas)

- Credit Support Default. When a party or its credit support provider (e.g. a guarantor or provider of letter of credit) defaults under a credit support document or the credit support document expires, is terminated or rejected. (see e.g. § 10.5 (a) (ii) and (iii) and § 17(2)(e) and (f) of the EFET General Agreement)

- Misrepresentation. If a representation made by a party under the master agreement proves to be materially incorrect or misleading. (see e.g. § 10(5)(e) of the EFET General Agreement)

- Default under other agreements. If the counterparties to a master agreement are equally bound by another separate agreement and one of the parties defaults under the other separate and specified agreement

- Cross-default. If a party or its guarantor defaults under an agreement it has in place with a third party, generally with respect to repayment of financial indebtedness. (see e.g. Section 10(5)(b) of the EFET General Agreement)

- Bankruptcy/Insolvency. A party experiences a bankruptcy/insolvency event. Typically, a list of events relevant to the jurisdiction of incorporation of the party will be referenced. (see e.g. Section 10(5)(c) of the EFET General Agreement)

- Change in Law / Illegality. As a result of an adoption or change in law, it becomes unlawful for a party to or its credit support provider to perform under the master agreement, or any credit support document (as applicable).

- Tax Events. As a result of a change in tax law, a party's tax position under the master agreement is materially prejudiced (e.g. withholding tax will be applied). (see e.g. § 14.8 of the EFET General Agreement)

- Credit Event upon Merger. If a party merges with or is consolidated into another entity, and the resulting entity is materially less creditworthy than the original entity. (see e.g. § 17(2)(i) of the EFET Power or Gas Agreement)

- Failure to deliver. When a party under a master agreement consistently and over a longer period fails to deliver a contractually agreed volume of commodity. or § 10(5)(d) of the EFET Power or Gas Agreement)

- Material error case. This clause entails the possibility to maintain the validity of the contract whilst material errors may have pre-empted the delivery of the commodity as initially agreed.

- Failure to provide credit support documentation. The failure or delay to provide a guarantee to a counterparty may be defined in contracts as a reason for suspension of the contract or termination.