Friends of the Earth Europe

Review of the Markets in Financial Instruments Directive
Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Response by Friends of the Earth Europe (FoEE)

The questionnaire takes as its starting point the Commission's proposals for MiFID/MiFIR 2 of 20 October 2011 (COM(2011)0652 and COM(2011)0656).

All interested stakeholders are invited to complete the questionnaire. You are invited to answer the following questions and to provide any detailed comments on specific Articles in the table below. Responses which are not provided in this format may not be reviewed.
Respondents to this questionnaire should be aware that responses may be published.
Please send your answers to econ-secretariat@europarl.europa.eu **by 13 January 2012.**

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Theme	Question	Answers
Scope	1) Are the exemptions proposed in Directive Articles 2 and 3 appropriate? Are there ways in which more could be done to exempt corporate end users?	- It is vital that the trading activities of the 'non-MiFID authorized' actors - largely institutional investors representing substantial volumes and positions - are monitored by the competent authorities (whether they are trading on own account or using the services of an investment firm). This should be the case via full pre- and post-trade transparency imposed on regulated markets and full post-trade transparency imposed on OTC transactions. - In general terms, exemptions for buy-side institutions (e.g. pension funds, insurance companies) and for entities dealing on own account are understandable, to the extent that they do not offer investment services *per se* to any third party. However, clarity is critical here, as firms should **only be exempt from MiFID in so far as their activities are solely and exclusively for the purposes of *genuine* hedging of risks core to their commercial business**, such as commodity or currency fluctuations. Furthermore, given the experience from the financial crisis that proprietary trading can be a source of financial instability and that the self-interest of dealers does not prevent financial disasters, exemptions based on dealing on own account, require further scrutiny. Particularly because the distinction between dealing on own account and for clients is somewhat artificial, at least for modern financial instruments. The exemptions should certainly be clarified, as they are currently quite opaque (e.g. **Directive Article 2 (d)** with its many negations). - Accordingly, it has to be ensured that buy-side institutions, like pension funds and insurance companies, are sufficiently covered by other pieces of legislation (IORP for pension funds, Solvency II for insurance companies, etc.) It is vital is that corporate governance requirements and conflict of interest provisions for these institutions are fully covered by their respective regulatory environment. - It should be noted that, as per **Recital 24** of the Directive, MiFID authorization aims at investor protection *AND* 'the stability of the financial system'. EP Resolution of 14/12/2010, §31 emphasized this by requesting that "significant market participants trading on their own account be required to register with the regulator and allow their trading activities to be subject to appropriate level of supervision and scrutinity for stability purposes". - There is certainly no need to go any further in exempting corporate users. For corporations that are active in or related to commodity derivatives markets for hedging purposes, but also quite often conducting speculative strategies, their activities and positions should be

		easily and clearly available to competent authorities to watch that they are hedging actual underlying positions rather than strictly speculating. - It has to be made very clear that the **exemptions *ONLY* cover the authorisation provisions in commodity derivatives markets and not the provisions for trading platforms**, for example, regarding high frequency trading and position limits, which should also apply to the entities exempted in **Article 2 and 3**. - Finally, the burden of proof that a corporation or institution is partaking in bona-fide hedging (and not speculating), for any trading transaction, must lie squarely on their shoulders, in order to be determined whether they should be exempt from MiFID.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	- It is appropriate and necessary to include emission allowances, given the regulatory landscape on emission allowances trading. It seems logical to include structured deposits.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	
	4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and what precedents should inform the approach and why?	- As it is key to ensuring a level playing field for both EU and non-EU actors in order to avoid regulatory arbitrage, provisions applying to services provided by third country firms are essential. The existing regulatory framework on this topic differs from one Member State to the other, and needs to be harmonized. - The principle that any third country firm providing services to retail clients (see question 18) should establish a branch in the Union, seems sound.

Corporate governance	5) What changes, if any, are needed to the new requirements on corporate governance for investment firms and trading venues in Directive Articles 9 and 48 and for data service providers in Directive Article 65 to ensure that they are proportionate and effective, and why?	- The underlying ambition of the new **Articles 9, 48 and 65** is to be welcomed, given the obvious and documented failures of proper corporate governance as partial causes of the recent financial crisis. - However, with respect to the **management body**, reference should be made to the need for coherence between the promotion of integrity principles and **remuneration**, which is often strictly determined by contribution to the firm's return on equity.
Organisation of markets and trading	6) Is the Organised Trading Facility category appropriately defined and differentiated from other trading venues and from systematic internalisers in the proposal? If not, what changes are needed and why?	- The European Commission's approach **(Regulation Recital 7)** to bring more of the current OTC derivatives transactions onto regulated venues, and to regulate broker crossing systems, is to be welcomed. However, **the proposed OTF category is not adequate** to achieve this. It seems highly unlikely that an additional trading venue category is the appropriate means to achieving this aim at all. - The OTF category largely overlaps with existing Regulated Markets (RM) and Multilateral Trading Facilities (MTF), but comes with extra privileges - or rather, less regulation - in the form of discretionary execution of orders and discriminatory access (the latter 'privilege' being granted to Systematic Internalises as well). Thus, **there is a risk that volumes currently traded on RMs and MTFs will migrate to the new lesser-regulated OTF environment**, which would be counter-productive in the extreme. - If OTFs bring any additional value to the current categories, it should be stated explicitly; the existing definition is in the negative. **Regulation Article 2, 1. (7)**: 'any system or facility which is not a regulated market or MTF'. **Directive Article 20 (2):** 'A request for authorisation as an OTF shall include a detailed explanation why the system does not correspond to and cannot operate as a RM, MTF or SI'. Provisions related to conflict of interest for MTFs (**Directive Article 19, 3**) should be replicated in the requirements for OTFs (i.e. in **Article 20**). - A more thorough assessment is needed regarding the question, what trading practices do not fall under the existing categories, and regarding the need to introduce a new type of venue – in line with the above-mentioned EP Resolution. Also, a more precise and restrictive definition of OTC is needed - , one which forces the migration of transactions that do not meet the definition's criteria onto the lit space of properly regulated markets.

	7) How should OTC trading be defined? Will the proposals, including the new OTF category, lead to the channelling of trades which are currently OTC onto organised venues and, if so, which type of venue?	- The definition of OTC trading should be based on the principle that all transactions should take place on a regulated trading venue (and cleared centrally – see EMIR), except in cases where such 'lit-trading' is detrimental to financial markets stability (e.g. large-in-size transactions). In other words, the driver for OTC trading should not be to benefit from (and maintain) a privileged position. - The current proposals are unlikely to lead to the channelling of OTC trades onto organised venues. Indeed, **Regulation Article 26** is entirely insufficient to guarantee the vast majority of opaque 'over the counter' (OTC) trading is brought on to regulated trading venues. Provisions to increase the standardisation of derivatives and ensure that new unregulated venues are not created are needed. - The lack of ambition of the European Commission proposals, to limit all OTC transactions across all instrument types to the strictest minimum, is appalling. The fact that only OTC derivatives transactions are defined is illustrative of this lack of ambition. - Without a clear definition of OTC, or an obligation to move OTC transactions to lit markets, except for derivatives, we do not see any reason why the proportion of OTC transactions would decrease at all for other asset classes. - On the contrary, as the new OTF category is 'lesser regulated', it might have an 'aspiration effect' on volumes currently traded on more regulated venues (RMs and MTFs), while not modifying the upwards trend of OTC and dark volumes.
	8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles 17, 19, 20 and 51 address the risks involved?	The risks involved are twofold, as noted in **Recital 48**: 'automated trading' should not 'create a **disorderly market** and cannot be used for **abusive purposes'**. - The first risk, of **disorderly markets** (due to malfunctioning technology), is adequately covered by the requirements in the Articles mentioned (including **clause 3 of Article 17**, aimed at avoiding sudden massive withdrawal of liquidity). - The second risk (the use of automated trading for **abusive purposes**) seems to be addressed by the **'liquidity-providing obligation' (clause 3 of Article 17)** – and should obviously be covered by MAD-MAR. High frequency trading in general (with notable exceptions) increases the volumes traded, but does not increase actual liquidity. Thus, the 'liquidity-providing obligation' proposed by the European Commission is to be very welcomed in this regard. - The provisions in **Directive Article 17** are intended to ensure the avoidance of acting "in a way that may create or contribute to a disorderly market". However, **no definition is given of a "disorderly market": It should be defined in terms of commercial**

		hedging and price discovery being disrupted in markets, both for the underlying asset as well as for the financial market in question. This is particularly important in the case of soft (or agricultural) commodities. The reasons for this are that high frequency algorithmic trading can add significant volatility to markets, disrupting the impact of information regarding fundamentals and flooding underlying price signals, destabilising markets and undermining effective price formation. Such trading can also cause markets to over-react to market events, significantly overshooting market equilibrium and contributing to the formation of bubbles. This impact is particularly dangerous in (agricultural) commodity derivative markets, where price signals should play a crucial role in allowing producers to forward plan production and mitigate price risk. Highly volatile derivative markets fundamentally undermine both these functions, leading to markets not responding correctly to restore equilibrium and producers being unable to manage risks effectively due to the prohibitive margin costs. The dangers of this form of trading are most clearly seen in the 'flash crashes' that took place in the international sugar market in late 2010 and the cocoa market in early 2011. Falling prices triggered the computerised models to automatically sell, fuelling a downward trend that led to prices falling 11 per cent for sugar and 12.5 per cent for cocoa in a single day. - While high frequency trading has been hugely profitable for commodity exchanges, which profit from the increased trading volume, it has been heavily criticised for providing little if any benefit to commercial hedgers. High frequency traders only enter the market for short periods of time and will often close out any positions at the end of every trading day. As a result they do not provide the long term hedging partner needed for commercial hedgers to transfer price risk. They should therefore be closely regulated if not prohibited.
	9) How appropriately do the requirements on resilience, contingency arrangements and business continuity arrangements in Directive Articles 18, 19, 20 and 51 address the risks involved?	
	10) How appropriate are the requirements for investment firms to keep records of all trades on own account as well as for execution of client orders, and why?	- The provisions contained in **Regulation Article 22** are to be welcomed. The increased capacity of regulators to anticipate risk can only be facilitated with the availability of sufficient historic data.

	11) What is your view of the requirement in Title V of the Regulation for specified derivatives to be traded on organised venues and are there any adjustments needed to make the requirement practical to apply?	- The aim to reduce OTC derivative transactions (**Regulation Articles 24 to 26**) is to be welcomed. It is in line with G20 recommendations, as well as numerous, widely valued academic and other analyses. - However, the current wording of **Article 26 – the 'sufficiently liquid' clause in particular – is too generic to assess whether the aim will be met. ESMA's role in implementing technical standards will be key in this regard**. The text of the regulation needs to be much more explicit on its ambition regarding the 'trading obligation' (for example, in terms of a proportion of trades). - It is often argued that derivatives are complex instruments with an ad hoc structure designed to meet the hedging needs of a specific investor in a specific situation. While this is obvious, it must be recognised that **the benefits expected from the relative standardization of derivative instruments** (i.e. market transparency and integrity) **outweigh by far the advantages of customization.** It should also be noted that the bulk of OTC derivatives dealing is done in so-called "exchange look-alikes", which means that their characteristics would have enabled them to be traded on a trading venue.
	12) Will SME gain a better access to capital market through the introduction of an MTF SME growth market as foreseen in Article 35 of the Directive?	
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?	
	14) What is your view of the powers to impose position limits, alternative arrangements with equivalent effect or manage positions in relation to commodity derivatives or the underlying	- Commodity derivative markets are increasingly dominated by financial, rather than commercial participants. According to an analysis of CFTC reports and other data, from 1998 to 2008, "physical hedger positions have risen 90%. During this same time, speculator positions have grown by more than 1300%."[i] **Financial traders frequently make trading decisions based on portfolio concerns, such as trends in stocks or**

	commodity? Are there any changes which could make the requirements easier to apply or less onerous in practice? Are there alternative approaches to protecting producers and consumers which could be considered as well or instead?	**currencies, rather than on information regarding the fundamentals of the underlying asset.** The extent to which this has taken place can be seen in recent reports that energy options traders are moving to soft (i.e. agricultural) commodities, highlighting the fact that trading strategies are based on the derivatives market, not knowledge of the underlying market.ii The effect of these market activities is a decrease of the correlation between derivative prices and physical market fundamentals, and an increase of volatility through momentum trading and certain forms of technical analysis. iii - **The result is that the markets' core functions of enabling price discovery and commercial risk management are disrupted**. A long list of academics and analysts and public bodies has uttered concerns about negative price-distorting influences of commodity speculation (see the reference document of the NGO WEED, Germany: http://www2.weed-online.org/uploads/evidence_on_impact_of_commodity_speculation.pdf). - **It is vital that position limits are used to curb the disruptive influence of financial participants within commodity derivative markets, whether regulated trading venues or OTC. This is especially important for food commodity derivatives.** A small amount of speculative behaviour related to commodities derivatives, when contained, may 'oil the machine' of hedging (for corporate end-users), but the real problem is the massive and unrestrained growth in speculative trading, and the financialisation of commodities through the creation of 'synthetic' financial products based on commodities markets. **Position limits can be used to set a sustainable balance of market participants that allow sufficient liquidity, avoid market abuse, retain price discovery to movements or information regarding the fundamentals and reduce the impact of certain 'uninformed' traders such as index funds**. - **Regulation Article 34** could result in ESMA only enforcing as little action as the most reluctant national regulator, and reducing the ability of national regulators in other member states to address threats. **Regulation Article 34** should be strengthened to avoid this. - **Regulation Article 35** should ensure that ESMA is able to act to reduce excessive liquidity in the commodity derivative markets if it is contributing to price volatility for the underlying assets. The measures in **Article 35**, granting ESMA position management powers, are to be welcomed. However, for these measures to reach their target, **clause 3**

		(a) should explicitly mention the limitation to hedging purpose, and be reworded to enable ESMA to act to curb excessive speculation. Clause 3 (c) should be removed, as it risks undermining the effectiveness of powers granted to ESMA. In addition, ESMA should be given powers to implement position limits on a permanent, not just temporary, basis. - Improved measures are needed to ensure meaningful position reporting data by defining categories of traders across all markets according to the nature of their main business in the **Regulation Article 60**. - It must be noted that position limits can only be implemented effectively if regulators have adequate resources, access to data and surveillance powers. This provides an additional reason for ensuring that the provisions for improved transparency within the commodity derivative markets are robust. - The aim of **Directive Article 59** is fatally weakened by the 'alternative arrangements with equivalent effects' clause, which must be removed: The clause would allow for regulatory arbitrage, and most likely fuel circumvention strategies of venue operators and market participants. In this respect, explicit emphasis should be put on the need for a precautionary approach, given the fact that the core purpose of commodity derivatives markets is hedging actual underlying positions, not speculation – as the latter has proven so damaging for society as a whole, inside and outside Europe (with regards to food derivatives, in particular). - **Directive Article 59, 1** must allow for imposing hard and also aggregate position limits on individual traders, categories of traders, as well as on markets overall, based on a percentage of the underlying market (see also the section with detailed comments on specific articles of the draft Directive, at the end of this document). - If position limits cannot be implemented in the way described above, or regulators are not adequately resourced to ensure proper surveillance, commodity derivative trading should be limited, and products that are purely speculative and which are not needed to provide liquidity for commercial hedging in these markets, such as commodity index funds and exchange traded funds, should be prohibited.

Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	- The banning of inducements in the case of independent advice (**Directive Article 24**) is to be welcomed as a step in the right direction.
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	- This is, to a large extent, dependent on the guidelines that EMSA develops, as to what is a 'structure that makes it difficult for the client to understand the risk involved' (clause 7.) However, we consider all commodity derivatives products to be complex. Thus, they should be considered as such according to **Directive Article 25**. This is because the commodity business is a highly risky and volatile one which is not suitable to most investors. Products that try to veil this riskiness by setting up index funds, exchange traded funds etc. are complex by their very nature e.g. given the roll of the futures and the many (financial) risks implied by this.
	17) What if any changes are needed to the scope of the best execution requirements in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	- The inclusion of execution quality in the reporting by trading venues and investment firms, which supports price transparency for investors, is to be welcomed. The provisions included in **Directive Article 27** seem satisfactory.
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	
	19) Are any adjustments needed to the powers in the Regulation on product intervention to ensure appropriate protection of investors and market integrity without unduly damaging financial markets?	- Any adjustments to **Regulation Articles 31 and 32** should aim at avoiding watering down ESMA's new powers. These powers are crucial in view of the recent obvious inability of major financial market players to self-regulate (i.e. avoid that their practices put market integrity and stability at risk). - **The ability to intervene on products directly when necessary should be a mandate for ESMA, not only a 'power at disposal'.** The conditions for the application by limits should be not too onerous for authorities, especially ESMA. - ESMA should not only be allowed to intervene "temporarily" (**Regulation Article 31-1**) but permanently.

		- As justification for intervention (**Regulation Article 31-2**) ESMA should also be allowed to take into account risks outside of financial markets, like the public interest, especially in the case of commodities. - The detrimental effect to the financial markets should not be taken into account as provided in **Regulation Article 31-3**. It is in the very nature of such measures that they might be directed against the financial markets. - Regulatory powers should be precautionary as well as reactive. A precautionary approach is appropriate in assessing and sanctioning new products specifically in agricultural commodity markets where the balance of potential benefit and harm in the physical market from new innovative products suggests that caution should be exercised. The risk of damage to the core functions of food commodity markets and to the physical market should not be overlooked in order to enable greater volume and profitability for financial participants.
Transparency	20) Are any adjustments needed to the pre-trade transparency requirements for shares, depositary receipts, ETFs, certificates and similar in Regulation Articles 3, 4 and 13 to make them workable in practice? If so what changes are needed and why?	- Pre-trade transparency, as a key element of the price formation mechanism, and a guarantee for fair markets, should be increased. - The fragmentation of trading venues has made it more difficult for investors, analysts and supervisors to obtain a complete and accurate picture at a given time. Firms with the means to invest in data consolidation and monitoring across venues are in a privileged position, which should be balanced by an easier and better access to all parties. - 'Consolidated quote solutions' should be explicitly supported in the Regulation – reference can be made to the US, where a 'Consolidated Quotation System' functions in parallel, and much the same way, as a 'Consolidated Tape System' – based on a 'utility' model.
	21) Are any changes needed to the pre-trade transparency requirements in Regulation Articles 7, 8, 17 for all organised trading venues for bonds, structured products, emission allowances and derivatives to ensure they are appropriate to the different instruments? Which instruments are the highest priority for the introduction of pre-trade transparency requirements and why?	- The structure of the different markets (nature of the demand, structure of the offer/intermediation) should result in a differentiated approach to pre-trade transparency. It is particularly important in (agricultural) commodities derivatives trading that transparency be given the highest priority, because of the social consequences of excessive price fluctuations.

	22) Are the pre-trade transparency requirements in Regulation Articles 7, 8 and 17 for trading venues for bonds, structured products, emission allowances and derivatives appropriate? How can there be appropriate calibration for each instrument? Will these proposals ensure the correct level of transparency?	
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	- The effectiveness of **Regulation Articles 4 and 8** – i.e. a definition of waivers that is not detrimental to the principle of pre-trade transparency – is jeopardised by the extent to which these definitions are subject delegated acts instead of further specification in the regulation. - The application of pre-trade waivers should be strictly coherent across member states, under ESMA supervision. - Current waivers, which are, de facto, creating dark pools, are too flexible, and detrimental to the efficiency of the price formation process. - The definition of waivers needs to be related to the definition of OTC (see question 7.)
	24) What is your view on the data service provider provisions (Articles 61 - 68 in MiFID), Consolidated Tape Provider (CTPs), Approved Reporting Mechanism (ARMs), Authorised Publication Authorities (APAs)?	
	25) What changes if any are needed to the post-trade transparency requirements by trading venues and investment firms to ensure that market participants can access timely, reliable information at reasonable cost, and that competent authorities receive the right data?	- In order for markets to function effectively, it is essential that price formation takes place through the free flow of information, and not through a small number of dealers exploiting information asymmetries to make profit at the expense of investors and clients. It is vital that pre- and post- trade transparency in non-equity products is introduced for both OTC and exchange-traded products to ensure that price formation can function effectively. - Post-trade transparency should be exhaustive, and disclosure should be as close to real-time as possible to allow supervisors to better foresee any risk related to activities of investment firms (similar to those that led to recent financial crisis). Disclosure implies

		access not only to supervisors, but to academics, independent observers, and the general public at large, who have a right to transparent information about financial actors who may be acting on behalf of them, or with their money. - Consolidation and format harmonization should be core principle of post-trade transparency. Standardization mechanisms should be defined to ensure maximum transaction traceability. - The provisions in **Directive Article 60** for real time reporting from members of regulated trading venues are welcome, but the following concerns remain: - **Article 60 (1)** – detailed reports should be regularly provided to regulators, not just on request. - **Article 60 (1)** – there is a risk that the minimum thresholds could be set too low to have an effect. - **Article 60 (1a)** – the **weekly reports should be complied and published by ESMA to ensure that the categories of traders are applied thoroughly and consistently.** If the compilation and publication is left to the trading venues – as now –, there is a risk of not having comparable and useful reports. - **Article 60 (3)** – the stated definitions are inadequate, particularly as regards "commercial undertakings". It is important that these categories be defined across all markets according to the nature of the actor's main business. Such a definition is included the equivalent US legislation, and so a similar definition in the EU would avoid regulatory arbitrage.
Horizontal issues	26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?	- The supervisory committee should ensure that third country interests, particularly the interest of developing countries, are duly taken into account. This relates to all effects that the activities of European markets and market actors have.
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	- There are two key challenges, facing ESMA and other authorities, for MiFID II and MiFIR to be properly supervised and enforced: These are the need for substantial and skilled human resources, and the capacity to consolidate, treat and analyse large amounts of data (which requires a very specific methodology, appropriate tools and experienced 'data intelligence' practitioners). - The current text does not provide sufficient guarantees that ESMA and Member States supervisors will be able to fulfil the ambitious role it is granted in numerous Articles

		(specifically regarding the above mentioned issues). - If not addressed, this situation could lead to a serious threat on the very ambition of the MiFID II and MiFIR package. - Because of the unique nature of commodity derivative markets, particularly agricultural commodities, ESMA should have, at least, a specialised unit for commodity markets. The US has a single specialised body for commodity derivatives with the CFTC, whose staff is much bigger than the entire ESMA. There is a serious concern that ESMA will not have sufficient means to exert any considerable control over these markets. - **Regulation Article 35** requires ESMA to engage in a proportionality test, and take into account whether a proposed intervention significantly address the threat, does not create a risk of regulatory arbitrage and does not have a detrimental effect on the efficiency of those markets, including reducing liquidity or creating uncertainty that is disproportionate to the benefits of the measure (**Article 35(3)(c)**). We are concerned that this proportionality test in risks undermining ESMA's ability to act. It is not clear the extent to which ESMA will have to demonstrate that it has considered each of the factors outlined in **Article 35(3)**. - In addition, we are concerned specifically in commodity markets that the Directive and Regulation should clarify that 'orderly functioning of markets' includes fulfilling the core purposes of facilitating risk management and price formation for the physical market, and that not 'reducing liquidity' refers to the useful liquidity required by commercial hedgers rather than the potentially harmful volume provided by excessive speculation. In the absence of such clarifications it appears that the proportionality test may prove unworkably difficult to satisfy in practice and that it may prevent ESMA from taking action to ensure commodity markets deliver their core functions effectively.
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	- Blanket exemptions under EMIR should not automatically guarantee similar exemptions under MiFID (and other forthcoming legislation such as UCITS V). - The provisions of the Market Abuse Directive have to be taken into account, especially in relation to algorithmic trading and in relation to commodity markets. If any measures are taken against any trader on basis of MAD, MiFID sanctions should also be possible as an additional deterrent. - The provisions of the EU's funds directives, especially the Directive on Undertakings for Collective Investments in Transferable Securities (UCITS) also need to be considered.

	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	- In order to avoid regulatory arbitrage, it is important that the provisions of MiFIR and MifID II are as strong as those in the US Dodd-Frank (Wall Street Reform) Act. - This includes the use of position limits to avoid excessive speculation in the commodity derivative markets distorting prices in the physical commodity markets. - It is also surprising that MiFID II and MiFIR do not explicitly address "swaps" even though they are one of the most prominent financial instrument in today's markets, and that the US devote a large part of their regulation efforts to these instruments. - **The look-through approach proposed by the U.S. authorities under the Dodd-Frank act provides a more exhaustive method to bring all commodities traders under supervision** than the MiFID approach, which puts obligations on exchanges. The risk of having a different approach on both sides of the Atlantic is to open the opportunity of regulatory arbitrage. In order to avoid that situation, **the EU should be at least as ambitious in its approach to commodities speculation**.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	- No. The fact that the Market Abuse Directive is partly transformed into a Regulation underlines the on-going problems with harmonised application and enforcement of EU legislation. Sanctions should be harmonized beyond minimum requirements to provide a sufficient deterrent, as market authorities will be limited in the number of cases they can handle due to the technical difficulty to gather evidence on many of the new provisions in MiFID. The Parliament should consider calling for a horizontal sanctions regime (possibly including criminal law) to be put back on the Commission's drafting board.
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	- Too much is currently left to Level 2 to allow for proper democratic and transparent debates on means versus objectives. This is especially so, given the considerable level of lobbying by the financial sector regarding this legislation: we consider that issues should be regulated at Level 1 rather than Level 2 to give full legal weight, increase transparency and avoid provisions being weakened. If regulating provisions are left to Level 2, there is good reason to fear that the rules will be watered-down by the Commission and financial lobbyists. In particular: **(1) Exemptions to Position Limits and 'Alternative Arrangements' should be defined at Level 1** **Article 59(3)** empowers the Commission to determine position limits, alternative arrangements as well as the conditions for exemptions. This is a weakness of **Article 59** as it leaves too much up to the Commission to decide without proper and transparent consultation with stakeholders. Therefore, MiFID 2 should be more explicit in defining position limits at appropriate levels,

		defining 'alternative arrangements' and in drafting exemptions to the limits. This level of detail is a crucial aspect of the Directive and would benefit from having full legal force and accountability from the Level 1 process. At a minimum, MiFID should define what the 'equivalent effects' of any 'alternative arrangement' to position limits should be, and explicitly require that this equivalent effects ensure the orderly functioning of commodity derivatives markets' key functions: to facilitate hedging of commercial risk and to facilitate transparent price discovery. **(2) Principles to consider when drafting Level 2 delegated acts** Any technical standards that are left to the Commission for Level 2 measures should reflect the following principles. These should include: o Aggregated position limits for all types of derivative contracts, applicable to all participants with narrow exemptions based on bona fide hedging. o A specific definition of 'bona fide hedging', that distinguishes between purely financial activities and risk management or hedging activities. o Elimination of any exemption for traders that would apply to their purely financial activities. All participants should be required to declare on a case-by-case basis what kind of activity they are undertaking and to justify any bona-fide hedge.

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Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
Article 59 :	**It is vital that improved measures are taken to enable position limits to be used to prevent excessive financial speculation contributing to food price spikes and interfering with commodity markets' intended purpose of enabling commercial hedging and price discovery. Directive Article 59 should be strengthened to reflect this, including allowing the use of aggregate position limits, and eliminating the option for weaker "alternative arrangements".** Because trading venues make a profit from the volume of trading carried out, there is a conflict of interest in the requirement that they apply position limits. Therefore **Article 59 (1) should be strengthened to ensure that authorities, if not ESMA, apply ex-ante position limits.** The application of position limits by ESMA would ensure uniformity across the EU, and avoid the risk of regulatory arbitrage. **These position limits should apply to commodity derivative trading conducted OTC as well as on regulated trading venues.** **Position limits should cover spot, single and all delivery month(s)** to prevent the rolling of funds before the spot month. Position limits which cover all tradable months are important for the price discovery function of these markets. Article 59 (1) should be strengthened to allow this. **Article 59 (1)** allows "alternative arrangements with equivalent effects such as position management with automatic review thresholds" instead of position limits. These "equivalent effects" are not defined, severely weakening this clause. **Position management is an inadequate response to the excessive speculation recently seen in the commodity derivative markets**. In the UK, for example, the regulator failed to exercise its existing position management powers at all in 2010, delegating responsibility to the commodity exchanges, and admits that it is unaware how often the exchanges themselves intervened in the markets. As a result, in July 2010 the hedge fund Armajaro nearly cornered the entire European cocoa market through the London exchange and in May 2011 Frontier Agriculture (linked to giant grain company Cargill) bought all the futures contracts on the London feed wheat market. These kinds of events could not have happened with clear and effective position limits. **We therefore recommend that "alternative arrangements with equivalent effects such as position management with automatic review thresholds" be deleted from Article 59 (1).** The conditions in Article 59 (1) under which position limits can be applied should be amended as follows to enable them to be used as part of a **precautionary approach** in which authorities act of prevent financial speculation from disrupting the core price discovery and risk management functions of the market. Position limits should be able to be used under any of the conditions listed without all conditions needing to be met: • **Article 59 (1a) should be amended to "support liquidity *for genuine hedging purposes*".** Increased liquidity above this level is

	associated with the disruptive effects described above. Liquidity should not be confused with trading volume, as liquidity also depends on participants' opinions and confidence, for example in their continued ability to trade. • **To Article 59 (1c), "ensuring commodity markets' core functions of enabling the hedging of commercial risk and providing price discovery for the physical market are fulfilled" should be added.** • **Article 59 (1d) should be added "to prevent or eliminate excessive speculation"**, with "excessive speculation" defined as trading by financial participants which exceeds the level required to allow sufficient liquidity for the genuine hedging needs of commercial participants and which drives price discovery at the expense of fundamental factors in the market for the underlying assets. **Article 59 (1)** also fails to make provision for aggregate position limits, which would be needed to avoid excessive concentration of a single group, such as financial speculators, within the market. Such aggregate limits could be used to ensure that there is sufficient liquidity to allow commercial hedging while minimising the negative impacts of excessive speculation. Currently only individual limits are permitted which, while they could be used to prevent market abuse, would be ineffective in addressing the excessive influence of a particular category of traders. Without aggregate limits, there is a risk of traders dividing their trading activities between different entities to circumvent individual position limits. **Provision for aggregate limits should be included within this Article 59(1)**. **Article 59 (3)** allows the Commission to determine position limits, and exemptions to them. Given the fundamental importance of this tool to ensuring that markets function effectively and do not have negative impacts for commercial participants, producers and consumers, we consider that **position limits and any exemptions, which should only be granted to corporate end users so far as their activities are solely and exclusively for the purposes of genuine hedging of risks core to their commercial business, should be set out clearly within the provisions of the Directive and or Regulation.** **Article 59 (4)** forbids national authorities from imposing more restrictive limits or alternative arrangements than those set out by the Commission. However there is a risk that, under Regulation Article 34, the Commission's actions to ensure consistency could be less than is necessary. In this case, **national authorities should be able to apply additional restrictions to address a threat. We therefore recommend that Article 59 (4) is deleted.**

Detailed comments on specific articles of the draft Regulation	
Article number	**Comments**
Article 26 :	Improved measures are needed to ensure that the vast majority of opaque 'over the counter' (OTC) trading is brought on to regulated trading venues. The current proposals in the **Regulation Article 26** are not sufficient to guarantee this, so provisions to increase the standardisation of derivatives and ensure that new unregulated venues are not created are needed.
Article 60 :	Improved measures are needed to ensure meaningful position reporting data by defining categories of traders across all markets according to the nature of their main business in the **Regulation Article 60.**
Article 35 :	**It is vital that improved measures are taken to enable position limits to be used to prevent excessive financial speculation contributing to food price spikes and interfering with commodity markets' intended purpose of enabling commercial hedging and price discovery. Regulation Article 35 should ensure that ESMA is able to act to reduce excessive liquidity in the commodity derivative markets if it is contributing to price volatility for the underlying assets.** **Regulation Article 35** allows ESMA to intervene with regard to participants' position, should national authorities fail to act. However, the conditions for this in **Article 35(3)** could undermine ESMA's ability to act. We therefore recommend that **Article 35(3a)** be reworded to enable ESMA to act to curb excessive speculation, and that **Article 35(3c)** be removed. In addition, ESMA should be given powers to implement position limits on a permanent, not just temporary, basis.

[i] Michael Masters and Adam White, *How Institutional Investors Are Driving Up Food and Energy Prices*,. The Accidental Hunt Brothers. 31/07/08. http://www.loe.org/images/080919/Act1.pdf

[ii] Meyer, G. (2011) *Energy options traders cotton on to soft commodity volatility*. Financial Times. 24/01/11. http://www.ft.com/cms/s/0/ff5fc2ac-27dc-11e0-8abc-00144feab49a.html#axzz1C2ccJpmk

[iii] UNCTAD (2009) *Trade and Development Report, 2009: Chapter II The Financialization of Commodity Markets*. United Nations. http://www.unctad.org/en/docs/tdr2009ch2_en.pdf

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