Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

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?	**Any exemptions to the Directive need to be (a) clearly defined and (b) specific and narrow in scope** – applied only where they are necessary to support the proper functioning of commodity derivatives markets. **All entities engaging in the same type of activities should be treated in the same way.** Currently the exemptions proposed do not satisfy either of these conditions. Physical commodity traders, including agricultural commodity trading firms, are increasing their participation in financial markets and service provision alongside traditional hedging activities. They may further expand their financial activities including engaging in and facilitating speculative trading if exemptions provide them with a further competitive advantage vis-à-vis banks and other financial institutions. While corporate end-users including grain traders may warrant some exemptions from the authorization requirements and on occasion from other rules for their commercial operations, these exemptions must not be extended to speculative financial activities. Where they trade and offer services in the same way as financial entities like banks and swap dealers, they should be subject to the same regulation, oversight, and transparency as those financial entities. **The scope of exemptions under Article 2 and 3 of the Directive should be explicitly restricted to Title II of the Directive on authorizaton and operating conditions for investment firms.** It should be made clear that exemptions to the authorisation requirements DO NOT prevent entities from being subject to the full rules (such as provisions on high frequency trading or position limits) that apply to participants on any trading venue they use, in particular the provisions of Title IV of the Directive on position limits and reporting. **The definition of activities 'ancillary to their main business' under Article 2(1)(i) needs to be clarified to prevent exemptions for speculative trading and to ensure that persons demonstrate in each case that they satisfy these requirements.** The regulations and the regulator can and should make a clear distinction between hedging and speculation and require participants to demonstrate that they satisfy the requirements to benefit from and exemptions for commercial hedging on a case-by-case basis. **Oxfam questions the need for pension funds to be granted an up-front exemption from the Directive in Article 2(1)(f).** Pension funds are financial services providers and should come within the scope of MiFID. The cost of regulation for market participants must be compared to the potential systemic cost to society of not regulating such market participants. Therefore, Oxfam would like to see this exemption from authorisation requirements in MiFID deleted.

Organisation of markets and trading		
	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?	Oxfam's view is that **only a relatively small number of commodity derivatives contracts are genuinely 'bespoke'** in the sense of being so unique, illiquid or difficult to price that they cannot be registered, reported and traded on organised platforms. **This is especially true for agricultural commodity derivatives**. It is often possible to disaggregate so-called bespoke OTC trades in fairly standard component parts and so they can be treated singularly or disaggregated in such a way for reporting and other purposes. The definitions of OTC trading should reflect this fact and attend to the strong need for as great a proportion of trades as possible to be transparent, subject to regulation and to open access and competition in order to improve market stability and efficiency and prevent hidden systemic risks.
	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?	**Oxfam supports the provisions that seek to improve regulation and supervision of algorithmic and high frequency trading**, and believes that the Directive should seek to ensure these requirements are robust enough to ensure full transparency, a level playing field without privileged access, and greater risk management.
	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	**Position Limits are a vital tool to prevent market abuse and to ensure commodity markets deliver their core functions of hedging and price discovery for commercial participants, which can be disrupted by excessive speculation.** **Ex ante position limits for commodity derivatives should be mandatory**, and not optional as set out in Article 59(1), and should apply to all participants, with minimum exceptions for bona fide hedgers. Appropriate limits should be used for all contracts and not just for the delivery month. **Other mechanisms might also be used to ensure markets function well, but these should be in addition to rather than as an alternative to position limits**. Position limits should be set at **appropriate levels** and should be reviewed periodically to ensure that they are not impacting negatively on market liquidity levels. This is particularly crucial in relation to agricultural commodity

	underlying 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?	derivatives. Clear ex ante limits can be effective in practice as a regulatory tool and also provide the benefit of certainty and consistency for both regulators and market participants. Position limits can and should be used as a precautionary measure to prevent as well as to respond to conditions of market disorder or other undesirable events. Experience in other markets demonstrates that it is possible to set ex ante limits at appropriate levels that are sufficient to be effective but do not threaten the liquidity needed to support core market functions for bona fide commercial hedgers. **The motives described in Article 59(1) under which position limits can be imposed are too narrow as they do not provide sufficient scope for limits to support core market functions.** The provisions should be amended to provide greater clarity for trading venues and regulators on the reasons for which position limits can be imposed and to ensure they can be set at the appropriate levels, taking into account the underlying purpose of the commodity markets, especially for food commodities. Article 59 should provide for positions to be imposed in order to: (a) **Support liquidity for bona fide hedgers**; (b) Prevent market abuse; (c) Support orderly pricing and settlement conditions; (d) **Ensure the delivery of commodity markets' core functions of enabling hedging of commercial risk and providing price discovery for the physical market**; (e) **Reduce or prevent excessive speculation**. Definitions of bona fide hedging and excessive speculation are suggested below and should be inserted in article 4 of the Directive. **There should be only minimal exemptions to position limits for bona fide commercial hedgers** and these should not be subject to misuse by persons wishing to avoid limits on speculative transactions. The proposals should clarify the primacy of hedgers as beneficiaries of commodity markets and provide specific guidance on what constitutes bona fide hedging, and how participants wishing to benefit from a hedging exemption should apply for and demonstrate that their transactions meet the definitions. Clear guidelines exist in other jurisdictions such as the US, where recent rulings under the Dodd Frank Act will strengthen existing rules, to perform this function. **Position limits should apply to classes of participants as well as contracts held by individual entities**. This would help address the use of multiple entities following a common strategy, including those participating in commodity index fund swap deals. It may additionally be necessary to prohibit the participation of certain classes of traders or the use of certain strategies and products (such as index funds and ETFs) if they have a harmful impact on market function and are not addressed by position limits or other arrangements. Finally, article 59 (4) should be amended to **avoid "a race to the bottom" between national regulators**.

Investor protection		
	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?	**Oxfam notes that the regulatory powers in MIFIR Art. 31 and 32 are only reactive.** This means that a product must already have been shown to be damaging the orderly functioning of markets before regulatory interventions can be made. **A balance towards more pre-authorisation requirements for new financial products before they can be offered on the market would be important to avoid harmful or risky financial products** becoming established and risks manifested before regulators can act. A precautionary, prophylactic 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		
	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?	**Oxfam supports the compilation and publication of a weekly commodity markets report by ESMA.** This should ensure the availability of accurate, comparable and useful reports (rather than ones that are fragmented according to the different trading venues) and should also pay attention to ensuring that positions are reported consistently and rigorously according to the different categories of transaction type and market participant.

Horizontal issues		
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	Article 35 of MiFIR empowers ESMA with certain position management powers provided that the measures address a threat to the orderly functioning of financial markets, including in relation to delivery arrangements for physical commodities, and provided that the national authorities have not acted to sufficiently address the threat. Further, ESMA must engage in a proportionality test and take into account whether a proposed intervention significantly addresses 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)). **Oxfam is concerned that the proportionality test in Article 35(3)(c) 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. This concern is explained in more detail below. It is critical that ESMA be provided with sufficient budget and resources to effectively perform its supervisory and regulatory functions. Oxfam is concerned that **ESMA should have a dedicated division dealing with commodity markets**, in order to take account of the complexity, specificity and importance of those markets.
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	Oxfam believes that **there are some key provisions that would benefit from being moved from Level 2 measures to Level 1** measures in order to give them full legal force stemming from the more transparent and accountable process involved in determining Level 1 measures. **(1) Exemptions to Position Limits and any additional position management arrangements should be defined at Level 1** Article 59(3) empowers the Commission to determine position limits and '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 'additional' rather than 'alternative' arrangements (see below for details of Oxfam's reasons for rejecting the inclusion of

		'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' or complementary effects of any additional or alternative arrangements to position limits should be, and explicitly require that these desired effects include to 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: • Aggregated position limits for all types of derivative contracts, applicable to all participants with narrow exemptions based on bona fide hedging. • A specific definition of 'bona fide hedging', that distinguishes between purely financial activities and risk management or hedging activities. • 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.

Detailed comments on specific articles of the draft Directive	
Article number	**Comments** N.B. Please note recommended changes to MiFID/MiFIR are highlighted ***in bold and italic*** below.
Article 2 MiFID	**Exemptions** **1. Commercial traders should not have blanket exemptions** Traditionally grain traders such as Cargill, Archer Daniels Midland (ADM), Bunge and Louis Dreyfus used commodity derivatives markets to offset or 'hedge' risks arising from their exposure to commodities. Today, however, grain traders are also increasingly involved in speculative trading on commodity derivatives markets – offering some of the same products and services to investors as banks and other financial institutions. Policymakers need to recognise this blurred role of traders – as hedgers AND speculators – when formulating new regulations. While grain traders may warrant some limited exemptions for their commercial operations, these exemptions should not be extended to cover their financial (speculative) business. Where traders are involved in the same speculative trading as banks, they must be regulated in the same way as banks. It is quite possible to distinguish between hedging and speculation, but this should be done by looking at the facts and circumstances of the trade concerned and the underlying activity to which it relates (i.e. that this activity must be commercial), rather than looking at the type of entity carrying out the trade. MiFID II reforms of commodity derivative market regulation should therefore require: - **Categorisation of trades by activity** (speculation or hedge), as well as by entity (commercial or financial participant). The burden of proof regarding the type of activity should rest clearly with the participant. - **Ex ante position limits**: Any exemptions to position limits should be narrowly restricted to 'bona fide hedging' by commercial participants, and bona fide hedging should be clearly defined. - **Trading to be done only on transparent venues**: All sufficiently liquid derivatives in all commodity markets should be traded on transparent platforms, without exemptions. **2. Pension funds should not have a blanket exemption** Oxfam questions the need for pension funds to be granted an up-front exemption from the Directive in Article 2(1)(f). Pension funds are financial services providers and should come within the scope of MiFID. The cost of regulation for market participants must be compared to the potential systemic cost to society of not regulating such market participants. Therefore, Oxfam would like to see this exemption from authorisation

requirements in MiFID deleted.

At a minimum this exemption should at be time-bound as it is in EMIR where pension funds are exempt from the clearing obligation for a period of 3 years, at the expiration of which the appropriateness of their exemption will be reviewed by ESMA.

3. Clarification of Scope of Article 2

The scope of **Article 2** is ambiguous. It is not clear whether Article 2 exempts persons from the entire application of MiFID (and MiFIR) or whether it is intended to merely exempt persons from the authorisation requirements for financial services providers contained in MiFID.

Article 2(1) should be amended in the following way to explicitly restrict the scope of exemptions to authorizaton and operating conditions for investment firms and clarify that these exemptions do not affect the transparency and reporting and other requirements which apply to any participant trading on the regulated exchanges, MTFs or OTFs, in particular the provisions of Title IV of the Directive on position limits and reporting:

> *Article 2*
> **Exemptions**
> 1. ***Title II of this Directive on authorizaton and operating conditions for investment firms*** shall not apply to:

A clear definition of 'authorisation requirements' should be given in **Article 4**, listing all of the authorisation provisions that persons will be exempt from pursuant to **Article 2**.

Article 2(1) should also clarify that these exemptions do not affect the transparency and reporting and other requirements which apply to any participant trading on the regulated exchanges, MTFs or OTFs.

4. Article 2(1)(i) and 'ancillary activity to their main business'

In addition to clarifying the general scope of Article 2, further amendments are needed in relation to the key phrase 'ancillary activity to their main business' in **Article 2(1)(i)**, which is given some definition **in Article 2(3)**. This requirement is vitally important to the proper operation of Article 2(1)(i), and therefore its definition must be clarified in the Level 1 process in order to specify the intended purpose of this provision and give it the full force and legitimacy resulting from the transparent and accountable process in place for Level 1 provisions.

Article 2(3) requires the Commission, when drafting the definition of 'ancillary to their main business' to take into account: '*The extent to which the activity is objectively measurable as reducing risks directly related to the commercial activity or treasury financing activity*'. These activities should be clearly defined in Article 2(3) of the Directive along the following lines:

- ***'Commercial activity' should be defined as using commodity derivatives for bona fide hedging or to offset risks arising from potential change in the value of assets, liabilities or services; and***
- ***'Treasury financing activity' should be defined as certain types of enumerated financial risk mitigating activities, such as to mitigate foreign exchange rate risk or fluctuations in interest/currency/foreign exchange rates.***

	Oxfam also recommends that Article 2(3) be amended to **specify the process by which persons must demonstrate that activities fall within those definitions in all cases**. To this end, the approach taken in the **'end-user exemption to the mandatory clearing of swaps'** in the United States of America, which has been strengthened as a result of recent rulings under the Dodd Frank Act and will shortly come into effect, may be instructive. Despite the fact that these provisions relate to the clearing obligation, we still feel that the comparison is useful in terms of the definitions and the approach that has been used to identify legitimate end-user exemptions. The 'end-user exemption' (see section 39.6 of the *General Regulations to the Commodity Exchange Act, United States*) is a provision that requires the applicant to be a non-financial entity (similar to requirement in Article 2(1)(i)) AND that the entity is in each case using swaps **to hedge or mitigate commercial risk** (defined in section 39.6(c) to include swaps that qualify as bona fide hedging or swaps that offset risks arising from potential change in the value of assets, liabilities or services, or financial risk such as foreign exchange rate risk or fluctuations in interest, currency or foreign exchange rates). **5. Clarification of Interaction between Article 2 and exemptions to Article 59(1)** The Directive should clarify that participants exempt from the Directive pursuant to **Article 2** are not exempt from position limits which are set by ESMA or national regulators and/or imposed by regulated markets and other trading venues. The exemptions to position limits, which are yet to be drafted pursuant to **Article 59(3)**, will be the only exemptions that apply in relation to position limits. Therefore, the Directive should make it clear that position limits (and any other requirements applicable to participants on the relevant regulated markets or trading platforms) apply *prima facie* to all participants, and that the general exemptions in Article 2 do not restrict regulated markets, MTFs or OTFs from applying limits in a consistent and comprehensive manner. See further details on Article 59 below.

Article 4 MiFID	**Definitions**
	
	1. Definition of Bona Fide Hedging
	
	The proposed amendment to Article 59(1)(a) (*see below)* – 'support liquidity for bona fide hedgers' would require a corresponding definition of 'bona fide hedger' to be inserted in Article 4 of MiFID. For guidance, the Commission may look to the United States.
	The definition of 'bona fide hedging transaction and positions' has been revised in section 1.3(z) in the General Regulations to the Commodity Exchange Act as a result of the recent CFTC ruling on Position Limits for Futures and Swaps which will soon come into force. Specifically in relation to position limits for futures and swaps, section 151.5 of the Regulations outlines the bona fide hedging and other exemptions for referenced contracts.
	
	Oxfam suggests the following definition of the general requirements for bona fide hedging be included under Article 4:
	
	A person will be exempt from position limit requirements if their transaction or position:
	• ***represents a substitute for a position taken or going to be taken on a physical marketing channel;***
	• ***is economically appropriate to the reduction of risks in commercial enterprise; and***
	• ***arises from actual or anticipated assets, liabilities or services; or***
	• ***reduces risks attendant to a position resulting from a swap that:***
	    o ***is executed opposite a counterparty for which the transaction would qualify as a bona fide hedging transaction under the above test; or***
	    o ***qualifies as a bona fide hedging transaction by satisfying the above test.***
	
	This definition is based on the revised rule published by the CFTC in the US, which proposes a 2 tier approach to the bona fide hedging exemption. Oxfam is of the view that this provides a good approach for dealing with exemptions for hedgers.
	
	First, a trader must meet the **general requirements** for a bona fide hedging transaction or position in s 151.5(a)(1). As described in the definition above. Second, once this general requirement has been met, they must also meet one of the enumerated provisions under s 151.5(a)(2)on **enumerated hedging transactions**. Or, if in relation to a swap, they must comply with s 151.5(a)(3) or (4) regarding 'pass-through swaps.'
	
	Guidance on what constitutes 'bona fide hedging'
	There are 8 listed, non-exhaustive, enumerated hedging transactions in s 151.5(a)(2) of the Regulations. An example of an enumerated hedging transaction in the US is the offsetting of sales and purchases in contracts (so long as the quantity does not exceed that of the underlying cash commodity), which recognises that the hedging of unsold anticipated production is an enumerated hedge (this includes anticipated agricultural production).

	Further guidance is provided in Appendix B to Part 151 which gives a non-exhaustive list of detailed examples of bona fide hedging transactions and positions in US commodity markets. **Differentiating between Hedging and Speculating** In order to differentiate between hedging and speculating, there are a number of approaches that may be used. The approach taken by the Commodity Futures Trading Commission in the US in its recent rulings to implement the Dodd Frank Act reforms and update the existing definitions and process used to make this distinction in the US may again be instructive. They distinguish between these two forms of trading activity based on the following: • Looking to the facts and circumstances at the time the swap is entered into, and should take into account the participants' overall hedging and risk mitigation strategies (based on assumption that the risk management strategies will help inform whether or not a particular position is hedging or speculating); • Importantly, the determining factor is not the type of organisation (whether a financial or non-financial organisation), but whether the underlying activity to which the swap relates is commercial in nature. **2. Definition of 'Excessive Speculation'** Oxfam suggests adding a new Article 59(1)(e) *(see below)* adding the reduction of excessive speculation as one of the motives to impose position limits (*see below*). Therefore, a definition of 'excessive speculation' should be inserted in Article 4 of MiFID. Oxfam suggests the following definition: ***'Excessive speculation' means trading by financial participants in commodity derivatives markets exceeds the level required to fulfil the transparent price discovery function of these markets and to allow sufficient liquidity for the genuine hedging needs of commercial participants.***

Article 59 MiFID	**Position limits** *Ex ante* aggregate position limits for commodity derivatives should be mandatory, and not optional as set out in Article 59(1), and should apply to all participants, with minimum exceptions for bona fide hedgers. Other mechanisms might also be used to ensure markets function well, but these should be **in addition to** rather than as an alternative to position limits. Position limits should be set at appropriate levels and should be reviewed periodically to ensure that they are not impacting negatively on market liquidity levels. This is particularly crucial in relation to agricultural commodity derivatives. Clear ex ante limits can be effective in practice as a regulatory tool and also provide the benefit of certainty and consistency for both regulators and market participants. **Oxfam suggests the following revised text for Article 59 (1):** 1. Member States ***must*** ensure that regulated markets, operators of MTFs and OTFs which admit to trading or trade commodity derivatives apply limits on the number of contracts which any given market members or participants can enter into over a specified period of time, ***and may apply additional arrangements in conjunction with and in support of these limits***, such as position management with automatic review thresholds, to be imposed in order to: (a) Support liquidity ***for bona fide hedgers;*** (b) Prevent market abuse; (c) Support orderly pricing and settlement conditions; ***(d) Ensure the delivery of commodity markets' core functions of enabling hedging of commercial risk and providing price discovery for the physical market;*** ***(e) Reduce or prevent excessive speculation*** The limits ***and additional*** arrangements shall be transparent and non-discriminatory, specifying the persons to whom they apply and any exemptions, and taking account of the nature and composition of market participants and to the use they make of the contracts admitted to trading. They shall specify clear quantitative thresholds such as the maximum number of contracts persons can enter, taking account of the characteristics of the underlying commodity market, including patterns of production, consumption and transportation to market. **Detailed Comments on Article 59** **1. Mandatory Position Limits** Article 59(1) provides little assurance that position limit powers will be exercised effectively and consistently by the regulated markets or operators of MTFs and OTFs (ie exchanges) unless they are mandated to do so. This concern is heightened due to the fundamental conflict of

interest that exists between the financial profitability of an exchange and the need to limit the amount of trading. Exchanges can increase their revenue by increasing the volume and size of transactions that are processed and as a consequence they have a clear disincentive to enforce position limits unless compelled to do so.

Article 59(1) should be amended to make position limits mandatory by stating that 'Member States ***must*** ensure that regulated markets…apply limits on the number of contracts which any given market members or participants can enter into over a specified period'.

Delete 'or alternative arrangements with equivalent effects' – replace with *'and additional arrangements in conjunction with and in support of these limits'*

'Alternative arrangements with equivalent effects' should be deleted from Article 59(1), as this gives too much scope for a loophole to emerge whereby less-effective measures than position limits can be put in place that would still satisfy this requirement. It also creates the prospect of an uneven and inconsistent implementation of regulatory powers and measures across different member states and trading platforms.

Oxfam acknowledges that binding *ex ante* position limits could be used **in combination with** other measures as part of a position management approach, but we stress that binding position limits are an essential component of such a system.

Therefore, this sentence in Article 59(1) should be amended to read: '...***and may apply additional arrangements in conjunction with and in support of these limits***, such as further position management with automatic review thresholds'.

Appropriate Levels at which to set Limits

When addressing the process of setting the appropriate limits to positions, it is important to acknowledge that it is possible to identify how much speculative trading volume has historically been sufficient to provide the necessary liquidity for hedging and price formation functions to be fulfilled. Evidence from the US suggests that speculation at 30% or below of activity in the market has historically been sufficient to provide the liquidity needed in commodity derivatives markets. There is a growing body of evidence from diverse sources that the overwhelming increase in speculation in recent years undermines the price discovery function of commodity derivatives markets and can contribute to increased volatility as financial speculators paying little attention to fundamental factors come to dominate price formation. This presents a threat to the delivery of core market functions and an undue burden to hedgers.

Therefore, position limits should be cautiously set at appropriate levels that are sufficiently tight to curb or prevent excessive speculation but not so tight as to threaten the liquidity needed to support bona fide hedging and price formation. A comparison of the usual configuration of the market compared to the usual positions that are normally taken (long/short and size of position) could be used to help set appropriate levels of position limits on a commodity-by-commodity and contract-by-contract basis as appropriate.

	2. Rationale and requirements for imposing position limits The reasons for which limits to positions can be imposed under Article 59(1) are too narrow as they fail to provide the necessary scope to permit position limits to be imposed to support delivery of core market functions other than in very generic terms. In order to give regulated markets greater guidance on the reasons for which position limits are to be imposed and to ensure that they can be set at the appropriate levels, amendments need to be made to Article 59(1) which take into account the underlying purposes of commodity derivatives markets. For the proper functioning of the food system (and indeed energy and other commodity markets) it is important that commodity derivatives are regulated in a way that ensures they are best able to serve their core purpose of providing price discovery and risk transfer, enabling hedging as strategy to cope with price volatility for commercial participants. **(a) 'Support liquidity' (Article 59(1)(a))** Article 59(1)(a) should be further clarified so that it provides the basis for ensuring that commodity derivatives markets perform their core functions, and that those functions are not subject to disruption by excessive speculation. Commodity derivatives markets have two main purposes: to facilitate risk management by producers, processors and consumers and to facilitate transparent price discovery. This understanding of the purpose behind the markets should be explicitly recognised in MiFID in order to clarify that this is an essential component of the orderly functioning of these markets and the crucial determinant of how much liquidity is necessary to ensure that functioning. Therefore, Article 59(1)(a) should be amended to read: 'to support liquidity ***for bona fide hedgers;'*** 'Bona fide hedgers' should then be defined in detail in Article 4 *(see above response on definitions in Article 4)*). **(b) 'Support orderly pricing and settlement conditions' Article 59(1)(c) to be complemented by new Article 59(1)(d)** The aim to 'support orderly pricing and settlement conditions' in Article 59(1)(c) provides for only a very narrow interpretation of orderly and effective market function. Therefore, it should be complemented by the addition of the following text: ***Article 59(1)(d) - ensure the delivery of commodity markets' core functions of enabling hedging of commercial risk and providing price discovery for the physical market.*** **(c) New Article 59(1)(e)** The position limit triggers in Article 59(1) must be expanded upon as they should empower Member States to require regulated markets and operators of MTFS and OTFs to impose position limits to take action to curb or prevent excessive speculation *(see above response on definitions in Article 4)*.

A new ***Article 59(1)(e)*** should be inserted to read:

> ***'reduce or prevent excessive speculation.'***

(d) In Oxfam's view the Directive should also be amended to clarify that **position limits may be imposed for any of these purposes**, and that it is not necessary to show that in every case they will support all of these purposes. This would allow for more robust and more appropriate position limits to be implemented in the EU.

Reasons for imposing position limits in other jurisdictions

For guidance, it is instructive to see how this point is addressed in the US for position limits in commodity markets. Under the CFTC rules published pursuant to the Dodd-Frank Act, position limits may be imposed to:

(i) Diminish, eliminate or prevent excessive speculation;
(ii) To deter and prevent market manipulation, squeezes, and corners;
(iii) To ensure sufficient market liquidity for bona fide hedgers; and
(iv) To ensure that the price discovery function of the underlying market is not disrupted.

3. Article 59(4) – Limits on powers of competent authorities: avoiding a "race to the bottom"

Article 59(4) restricts competent authorities from imposing limits or alternative arrangements which are more restrictive than those adopted in the delegated acts, except in exceptional cases where they are objectively justified and proportionate taking into account required liquidity and the orderly functioning of the market.

In order to avoid a "race to the bottom" between national regulators, Oxfam believes that Article 59(4) would be stronger if it were amended to prevent competent authorities from imposing limits or alternative arrangements which are ***less*** restrictive than those specified in the delegated acts.

4. Key points to consider when drafting exemptions to position limits

(a) Bona fide hedging activities

The exemptions to position limits that are to be defined in future delegated acts should be restricted to bona fide hedging activities, which means that only businesses dealing directly in physical commodities and using commodity markets to hedge risks core to their commercial business should be exempt. Participants must declare and demonstrate for each transaction under which they wish to apply for an exemption the reasons for which it is a bona fide hedge and specify the commercial positions that relate directly to this hedge. They should also notify the relevant authority when making any changes to transactions classified as bona fide hedges.

(b) Approach to Pass Through Swaps

	In the US, the CFTC has made it clear in its rulings under the Dodd Frank Act that a pass-through swap will only be recognised as bona fide hedging to the extent it is executed immediately opposite a counterparty eligible to claim an enumerated hedge exemption, and not if it is instead just part of a network of transactions connected to a bona fide hedger. This approach should be kept in mind by the Commission when drafting the delegated acts as it addresses the potential for a 'swap dealer loophole' (where non-hedging counterparties to such swaps were able to offset non-referenced contract swap risk by claiming a bona fide hedging exemption).
Article 31 & 32 MiFIR	**Product Intervention – powers of ESMA and competent authorities** Oxfam notes that the **regulatory powers in MIFIR Art. 31 and 32 are only reactive**. This means that a product must already have been shown to be damaging the orderly functioning of markets before regulatory interventions can be made. A shift towards a proactive approach is needed: **pre-authorisation requirements for new financial products** before they can be offered on the market would avoid harmful or risky financial products becoming established and risks materialising before regulators can act. A precautionary, prophylactic 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. As described above, it must be made clear that the definition of 'the orderly functioning and integrity of financial markets', as included in Article 31(2)(a) under the conditions under which ESMA is empowered to act, includes preserving the ability of commodities markets to deliver their core functions of risk transfer and price discovery and, to that end, preventing excessive speculation.
Article 35 MiFIR	**Position management powers of ESMA** This comment builds on the response to Question 27, above, which has recommendations on the tests that ESMA must satisfy in order to act in the absence of sufficient response by national authorities to threats to market function. **Proportionality approach to the risk of regulatory arbitrage** Article 35(3) of MiFIR directs ESMA to take into account a number of considerations before implementing any position management measures that ESMA deems necessary and appropriate. These considerations include that the measure 'does not create a risk of regulatory arbitrage' in Article 35(3)(b). It is important to specify that EMSA can weigh the listed factors, and that it is not an absolute prohibition on measures if they cause some regulatory arbitrage. Instead, the risk of regulatory arbitrage should be considered alongside the level of risk and the tolerance for such risk, being a function of the potential damage to the markets that is being addressed by the proposed measure under consideration by ESMA. The public's interest in properly functioning commodities markets and the effects of financial markets on physical commodities markets form the basis for fixing position limits (ex-ante and ex-post). **'Orderly functioning and integrity of markets' to provide transparent price discovery and to facilitate risk management** In the alternative, the key phrase the 'orderly functioning and integrity of financial markets', which is used throughout Article 35, needs to be clearly defined. For example, price discovery is a key purpose to commodities markets, and should form part of the definition of 'orderly functioning and integrity of financial markets'. This is because a market can appear on the surface to be operating in an orderly manner, except that the price curve generated by the trading is reflective of influences unrelated to the fundamentals of supply and demand and the market is not fulfilling one of its main functions. Therefore, the definition of 'orderly functioning and integrity of markets' needs to be based on a clear

	explanation of the fundamental purpose of commodity derivatives markets in order to establish whether they are functioning in an orderly manner or not. In relation to commodity markets, the purpose of the market is to provide transparent price discovery and to facilitate risk management strategies for farmers and buyers. This should be clearly explained in MiFID and MiFIR 2. This should be dealt with either in the Preamble, or in the definitions section in Article 4.