Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Response from Shell Energy Europe

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.

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?	• We note that the previous commodity exemptions 2.2(i) and 2.1(k) were originally introduced on the basis that further analysis would be undertaken to determine the appropriate regulatory treatment of specialist commodities firms. We are not aware of any such further work being done. As such, we are not clear on the basis upon which the exemptions have been changed or removed, and more specifically, no case has been made to demonstrate that these previous exemptions were inappropriate or resulted in any regulatory failure. • Given the links between MiFID/MiFIR and the prudential capital rules under CRD, we consider that the exemptions

		must be properly constructed in order to avoid the inappropriate capture of firms within this regime. • It should be noted that an exemption for commodities firms does not mean that they will be unregulated, but rather they will be subject to national regulatory measures in each market and other commodities specific laws. • Shell further considers that the exemption regime should reflect the level of risk that non-financial parties represent. As such the previous exemption regime also recognised the difficulty in applying rules for financial institutions to corporate players. Corporate entities operate in the market at different levels of sophistication which is generally linked to the size and complexity of their business. Shell considers that trying to draw a line through the corporate space will be difficult, may create an uneven playing field in commodities and emissions, and could result in a retreat from trading and/or restructuring around the rules. • To the very limited extent that non-financial commodities firms may add to systemic risk, Shell considers that many of the measures contained in REMIT and EMIR along with other improvements in market transparency and added security through measures directed at particular markets should be sufficient without creating burdens that promote uneven treatment and unintended consequences for the energy liberalisation program. • Given the above, and the high level of uncertainty around the application, definition and consequences of the remaining exemptions, Shell urges caution and suggests careful

	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	• Shell believes that the proposal to define Emission Allowances (EUAs) as a separate class of financial instruments in MiFID II is not appropriate. Although EUAs do share some common features with other classes of financial instruments, such as transferable securities (e.g. dematerialised bearer bonds held in a clearing system), they are distinguishable from such types of financial instrument for several reasons. They do not confer financial claims against the public issuer of such allowances; they do not represent titles to capital or title to debentures or constitute forward contracts. The operators of installations subject to the ETS system are effectively forced to trade EU allowances to ensure that they comply with emissions reductions limits and to avoid sanctions in case of non compliance. EU allowances primarily serve cost efficiency in climate protection and they are not, and were never intended to be, primarily investment products. • While we understand the pragmatic reasons for finding a way to better regulate the EUA market, we do not consider that MiFID is the appropriate tool to achieve this, particularly given the risk of unintended consequences (which may include increasing the cost of compliance for smaller compliance players). Structural changes to the market to increase market stability and security are already being introduced via the recent Registries Regulation establishing

		• Should EUAs remain within licensing scope of MiFID II there must be greater clarity to ensure that non-financial firms that are compliance buyers are treated in a way that maintains a level playing field and does not draw arbitrary distinctions between corporate players. One of the tools to do this may be to look at the calibration of the exemptions. • We consider that the emissions allowance primary market should be specifically excluded from the scope of MiFID II and we understand that IETA will be coming forward with some language to this effect in due course.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	• Shell has no view on this question.
	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?	• Extraterritorial rules can be very difficult to design and implement. There is a large risk that such measures may appear to amount to trade barriers and be subject to political influence. • Uneven application of rules across the main markets could place Europe at risk, and there should be significant caution on managing both regulatory gaps and overlaps. • Companies operating across a number of countries should have certainty on the regulatory treatment of activities and

		• Companies need ex-ante clarity on where and how they will be regulated, and also need a clear order of priority where there are uncertainties and overlaps. • Pragmatism is also required when assessing whether third countries offer equivalent levels of regulatory scrutiny. Like taxation, a certain amount of competition and differences should be acceptable and international consensus will be important.
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?	• Shell has no specific views on this question
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?	• There seems to be a clear distinction between OTFs and other types of trading venues. Our main concerns relate to the treatment of products traded on this new type of platform. • Shell is concerned about the implications and unintended consequences that the introduction of OTFs might have for the energy market as the definition is very broad, (e.g. its inclusion in Annex I, C6 as currently drafted appears to bring physical forward transactions into the scope of regulation as Financial Instruments purely by virtue of where they are traded rather than on the basis of the nature of the product.) • Greater clarity is required to keep physical forward trades out

		• At this stage the impact appears very wide and is potentially in conflict with physical market activity which is subject to other regulatory measures, and we are unsure whether this is intentional or not. We are strongly opposed to the reclassification of physical forwards as Financial Instruments by the back door, as we feel it is neither appropriate nor correct.
	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?	• Shell considers that OTC trading should be defined as trades that are bilateral in nature, included those that are performed through broker platforms (cleared or otherwise). • The new OTF category blurs the distinction between traditional OTC and exchange based trading, and we would expect some activity to move to OTFs. However, bespoke contracts should be allowed to continue to utilise OTC approaches in order to maintain market efficiency and to recognise that many physical commodity market dealings require flexible design and are not suited to standardisation. • As noted in our response to Question 6, we have concerns about the expansion of the scope of MiFID to capture physical markets. The amended Annex 1, C (6) classifies a contract that is settled physically and traded on an organised trading facility (OTF) improperly as a financial instrument. • Physically settled forward products in particular are of primary use for commercial firms. Their incorrect reclassification as Financial Instruments would increase the scope of MiFID to pure commercial activities (i.e. gas/power

		• In addition this has considerable implications regarding the framework of non financial firms under EMIR and the enforcement of position limits, position reporting or equivalent measures under MiFID. • Shell considers that a clearer distinction between physical and financially settled commodities instruments is required and that the definitions of classes of Financial Instruments should relate to the characteristics of the product and not the trading venue. This is the approach used in the US under the Dodd-Frank Act, and as such any departure from this approach in the EU would create regulatory inconsistency. • As noted earlier, physical energy markets are now subject to greater regulatory scrutiny through specific measures such as REMIT and EMIR and as these markets have not been identified as sources of systemic risk, it would be disproportionate to further increase regulatory capture from the additional requirements and obligations in MiFID.
	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?	• Shell has no specific views on this.
	9) How appropriately do the requirements on resilience, contingency arrangements and business continuity arrangements in Directive Articles 18, 19, 20 and 51	• Shell is generally supportive of requirements for good business practices, but has no specific comments on the

	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?	• Investment firms should be able to properly identify proprietary and client order trades in order to properly allocate value and demonstrate compliance with business conduct rules.
	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 "trading obligation procedure" defined in MiFIR (art 26) provides that the class of derivatives (or a relevant subset thereof) considered sufficiently liquid should be traded <u>only</u> on organised venues i.e. regulated markets, MTFs or OTFs. • Shell believes that the tests of liquidity should be quite strong as commodity trading across Europe is less mature than in the US, and inappropriate classification could act to constrain market development. • It is not entirely clear that dictating trading venues will improve market efficiency or lower systemic risk, so any perceived improvements in terms of transparency should be assessed and not assumed. Further, interactions with other regulatory measures such as EMIR should be properly considered.
	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?	• Shell is not in a position to comment on the impact on SMEs
	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	• We welcome rules to ensure non-discriminatory access to market infrastructures. We believe that rules on conditions to access central counterparties and trading venues should be

	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? 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?	• Shell does not support the empowerment of regulated platforms (e.g. exchanges) and regulators to establish arbitrary ex-ante position limits in respect of commodity derivatives. • Regulation of commodity markets needs to shift from the political and guesswork to objective evidence and dispassionate analysis. It is the fundamentals of demand and supply that are the key drivers of both price levels and volatility. There is no conclusive study to support the assertion position limits will either contain or deter manipulative practices. • Shell supports the use of position management primarily in the hands of exchanges. This is recognised by most stakeholders as the optimal tool to ensure commodity markets function safely and effectively. . • We believe that regulatory supervision of positions with appropriate ex poste data is a sufficient measure to ensure the proper functioning of markets. Any imposition of limits should not be arbitrary but instead be within a position management regime, be the last option to tackle market dislocation. It is important that a tool of last resort only be deployed when subject to strict conditions. • If Regulators are given powers to impose limits they should all be subject to similar conditions when assessing appropriateness.

		• on limits hinder effective risk management as companies would be allowed to manage their commodity price risks only up to a certain level which could leave unhedged risks, and thereby increase business costs and overall risks. • Whereas position management allows companies to demonstrate the need to take positions aimed at risk management activities which may vary over time and can be responsive to market disturbances. Position limits are more likely to be quite static in nature and more likely to be set at inappropriate levels in the first instance and be very unresponsive to changing market circumstances. • Shell also has concerns about the imposition of position reporting in real time as this appears too ambitious and alternative, proportionate arrangements have to be introduced that do not disrupt the normal functions of a market. We would urge the use of proportionate measures which reflect the implied risk of trading activities. • As part of the new arrangements it may be appropriate to more clearly specify the responsibilities of operators of regulated markets, MTFs and organised trading venues to ensure the positions taken by firms trading on their platforms do not undermine market integrity or create systemic risk.
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?	• Shell has no specific views on this question.

	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	• Treating derivatives as complex products will make firms far more reluctant to deal in derivatives with government bodies and municipalities as the risk of unenforceability will increase.
	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?	• Shell is supportive of best execution rules, but has significant concerns about onerous reporting arrangements. • We would observe, however, that often best execution rules serve no practical purposes in the energy markets given the bespoke nature of contracts and the fact that these are typified by clients "shopping around" for quotes and thus providing for their own best execution. We would note that the CFTC has dropped their proposed best execution standard for Swap Dealers and Major Swap Participants with regard to their counterparty dealing.
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	• Shell has no specific comments on this question.
	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?	• Shell has no specific comments on this question.
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?	• Shell considers that the waiver mechanism should apply broadly unless otherwise removed, which will place the onus on the Regulator (ESMA) to assess actions on a product by product basis without disrupting the functioning of the market.
	21) Are any changes needed to the pre-trade transparency	• Shell considers that the current level of pre-trade

	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?	transparency in regulated markets is sufficient to show the price and depth of the market. • We have concerns about measures which seek to extend this across to OTC trading mainly because bespoke bilateral trade conditions reflect a number of underlying factors between the trading counterparties (including for example credit arrangements). Also, having greater transparency of such deals can expose commercial positions to the wider market to the cost of the contracting parties.
	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?	• See the answer to Q21.
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	• See the answer to Q20
	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)?	• Shell has no specific comments on this question.
	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?	• Shell's main concern is that the post trade requirements are properly specified, and are pragmatic in application to ensure that compliance costs are not excessive. • With the application of EMIR we would expect that the most liquid standardised products will be traded on regulated

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 existing drafts of MiFID II/MiFIR (and EMIR) rely in a number of places on level 2 implementation measures to be issued by ESMA after the time the primary legislation is to take effect. The scope of the ancillary exemption 2.1(i) in MiFID II is an example of this. The adoption of this approach will make it difficult for firms to make an effective assessment of the potential impact of the legislation on their activities in advance of its impact or to arrange their activities appropriately at the point at which they are required to comply, which are both serious drawbacks from an implementation point of view.
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	• Shell has no specific comments on this question.
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	• The main financial services legislation that has interactions with MiFID/MiFIR II is the European Market Infrastructure Regulation (EMIR), the Capital Requirements Directive (CRD) and the Market Abuse Regulation (MAR). All these are currently in their legislative process. • The separate development of these legislative initiatives raises significant risks of inconsistency and uncertainties with how they are to be applied and any cross interactions. The mark of any good policy is that it can be effectively implemented and administered. Our main concern is that in the haste to meet G20 demands, the legislation will not have

		• II should respect the broader program and legislation specifically aimed at the development and regulation of energy markets, including the Regulation in Energy Market Integrity and Transparency (REMIT). • Shell considers that there should be clear distinctions on the issue of scope, and due reference to the level of regulatory control already in place in the commodity and emissions space.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	• We underline in particular rules concerning the energy sector included in the Dodd-Frank Act approved in the US. Shell strongly supports a better specification of the MiFID II perimeter to exclude from the definition of financial instruments all products with delivery in the future that are physically settled. This is the approach used in the US under the Dodd-Frank Act, and as such any departure from this approach in the EU would create regulatory inconsistency (see also answer to 7).
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	• The proposed limit on pecuniary sanctions of up to 10 per cent of a consolidated undertakings turnover is, in our view, an onerous upper limit to apply to the activities of regulated firms operating as subsidiary entities within a group whose business consists of activities otherwise of a non-financial nature.
	31) Is there an appropriate balance between Level 1 and Level 2	• Please see the answer to Q26 as to the policy and

	measures within MIFID/MIFIR 2?	implementation risks associated with the existing approach to Level 1 and Level 2 issues.

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
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