FESE response to the UK FCA consultation on reforming the commodity derivatives regulatory framework

16th February 2024, Brussels

Q1: Taking into account the proposals outlined below, do you have any specific comments regarding the implementation of the new regime? Please explain your answer.

N/A

1. Scope of the position limits regime

Q2: Do you agree with the approach outlined, including the criteria to assess the criticality of contracts? If not, please explain why.

FESE fully supported the amendments brought by the EU MiFID "quick fix" to the position limits regime. The new rules alleviated the rigidity of the previous system by identifying a set of contracts denominated "critical", to which position limits apply. As such, FESE fully supports the move proposed by the UK FCA to adopt a similar system, identifying a subset of critical contracts to be included in the scope of position limits. The new regime will deliver a more proportionate and efficient regime which would allow new and nascent products to develop but would also deliver transparency in commodity markets and address excessive commodity price volatility.

Q3: Do you agree with the approach outlined above with respect to related contracts? If not, please explain why.

N/A

Q4: Are there any specific types or classes of contracts that should not be included in the related contract concept? If so, please explain why.

N/A

Q5: Do you agree with the proposed approach to update the list of critical contracts? If not, please explain why.

We believe that the system for adding or removing contracts from the list of critical contracts should strike a balance between adopting decisions in a timely way and allowing a window of opportunity for market participants to provide their feedback to the FCA. In particular, it will be fundamental to gather feedback from the trading venue where a particular contract under scrutiny is traded. As such, we in principle agree with the proposal from the FCA.

Q6: In notifying us of a particular market that requires closer monitoring, are there any other factors that trading venues should consider? If you think there are, please explain what the additional factors are and why they should be considered.

N/A

Q7: Do you agree with the list of critical contracts above? If not, please explain why.

N/A

Q8: Should any of the three cash-settled contracts mentioned above (Dated Brent Future, Dubai 1st Line Future, Singapore Gasoil (Platts) Future) or the physically settled Permian WTI Future be added to the list of critical contracts? If yes, please explain why.

N/A

Q9: Taking account of our proposals on position management and the reporting of additional information, do you consider that the risks arising from positions held OTC are adequately dealt with despite the fact that position limits do not apply to OTC contracts? If not, please explain why.

N/A

2. Setting position limits

Q10: Do you agree with the approach and framework outlined above for setting position limits? If not, please explain why.

FESE fully agrees with the transfer of responsibilities for setting position limits from the FCA to the relevant trading venues.

Commodity derivatives are global products that are traded in a highly competitive environment, and it is, therefore, crucial that jurisdictions which host such markets tailor their regime to meet the needs of international customers while ensuring high regulatory standards that focus on outcomes. In this regard, FESE strongly supports a more dynamic and market-led approach, avoiding setting fixed position limits while giving trading venues increased responsibility for setting controls to ensure orderly trading, settlement, and delivery. As the FCA states, trading venues have the market proximity to set position limits effectively and to quickly change them if market conditions require.

Overall, trading venues are best placed to conduct these tasks and have operated sophisticated position management regimes since before the MiFID II entry into force. It was a successful approach which was delivering the right outcome. As such, FESE fully shares the proposed way forward by the FCA.

Q11: Do you agree with the criteria trading venues shall consider when developing their position limit setting methodology and when setting position limits? If not, please explain why.

Building on the response to the previous question, FESE fully shared the objectives stated in the wholesale market review (WMR). Based on the content of the current consultation paper, FESE would suggest caution in the way the FCA is proposing its set of criteria for trading venues to take into account when developing its position limit methodology.

The WMR suggested that the FCA's rules should establish a high-level framework and a set of core principles, whilst delegating the details to the exchanges. This would allow each exchange to tailor the arrangements for its specific markets, whilst, at the same time, the FCA should retain appropriate oversight capabilities to ensure that the objectives of each regime would be delivered. FESE believes that the FCA's current consultation paper seeks to determine a considerable amount of detail within the FCA's rules (e.g. line 4.30), which may run the risk of limiting the scope for tailoring the arrangements for different commodities.

Whilst we recognise that many of the aspects mentioned by the FCA would, in fact, be used to construct the specific arrangements for position limits, FESE suggests keeping the list high-level without specifying the details of each item. The FCA would, anyhow, have the power to review the specific methodology adopted by each trading venue and consider the reasoning behind how position limits are constructed.

3. Exemptions from position limits

Q12: Do you agree with the approach to granting exemptions outlined above? If not, please explain why.

In line with the general review of the position limits regime, i.e. transferring of responsibilities from the FCA to the relevant trading venues in setting and managing the system, FESE agrees that trading venues be responsible for the granting and ongoing monitoring of exemptions.

Q13: Do you agree with the approach to the hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

N/A

Q14: Do you agree with the approach to the pass-through hedging exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

N/A

Q15: Do you agree with the approach to the liquidity provider exemption outlined above and the information to be provided to evidence use of the exemption? If not, please explain why.

FESE supports a position limit exemption for financial counterparties under mandatory liquidity provision obligations. Furthermore, such an exemption should not be limited only to financial counterparties but also include non-financial counterparties as, in many cases, they fulfil mandatory liquidity obligations as well.

4. Position management controls and reporting

Q16: Do you agree that trading venues should establish accountability thresholds for critical contracts?

N/A

Q17: Do you agree with the approach outlined above and the factors that should be considered as part of the trading venues' accountability threshold setting methodology? If not, please explain why.

N/A

Q18: Do you agree with the set of conditions that result in the requirement to provide additional reporting? If not, please explain why.

N/A

Q19: Do you agree with the information to be reported once the additional reporting requirement is triggered? If not, please explain why.

N/A

Q20: Do you agree with the definitions of related OTC contracts and overseas contracts? If not, please explain why.

N/A

Q21: Do you consider that additional reporting requirements should apply at a group level rather than entity level for the reasons highlighted in paragraph 6.33 above? If not, please explain why.

N/A

Q22: Do you agree with the proposal for trading venues to develop a periodic market risk analysis report? Please explain your answer.

N/A

Q23: Do you agree that trading venues are best placed to determine for which contracts CoT reports should be published or do you have views on how the criteria should be amended? Please explain your answer.

N/A

Q24: Are there any other changes to the public reporting of aggregated positions that you consider appropriate? If yes, please explain the changes you propose and why they are necessary.

N/A

5. Perimeter

Q25: Do you agree with the proposed guidance on the Ancillary Activity Test? If not, please explain why.

N/A

Q26: Do you have any other views on the points outlined above?

Concerning the position management control and reporting scope, the FCA is proposing to enhance reporting from firms to trading venues to include derivatives traded on overseas markets.

It is important to ensure that the framework manages the conflict between commercial interests and regulatory obligations of trading venues. In particular, it should be avoided that UK trading venues can request position data regarding positions in derivatives traded in overseas markets with whom they are in direct competition as this data constitutes commercially highly sensitive information. As such, FESE calls for the FCA to reconsider the merit of its proposal.