



THE IMPACT OF FINANCIAL REGULATION ON THE COMMODITY MARKET



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Financial regulation overview

Impact on Commodity Market

Reflection



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Overview

MiFID II/ MiFIR - Markets in Financial instruments Directive/ Regulation (DIRECTIVE 2014/65/EU/ REGULATION 2014/600/EU)

MAD/ MAR - Market Abuse Directive/ Regulation (DIRECTIVE 2014/57/EU / REGULATION 2014/596/EU)

CRD IV/ CRR - Capital Requirements Directive/ Regulation (DIRECTIVE 2014/36/EU / REGULATION 2014/575/EU)

EMIR - OTC derivatives, central counterparties and trade repositories (REGULATION 2012/648/EU)

SFTR - Transparency of Securities Financing Transactions (REGULATION 2015/2365/EU)

Benchmark – Benchmark regulation (will be adopted in summer 2016, valid approx. January 2018)

FTT – Financial Transactions Tax (under discussion)



MiFID II/ MiFIR (in force – January 1st, 2018)

Key elements for commodity industry

Definition of financial instruments (FI)

- Financial settled Commodity Derivatives are in scope
- REMIT carve out - physically settled gas & power contracts traded on OTF are exempted
- Emissions are fully in scope – forwards & spot

Ancillary Activity test

- Main business test (MBT) and
- Market size test (MST) shall be passed for exemption

Position Limit

- Position limits are set by competent authority (national level) on size of net position in commodity derivatives traded on RM, MTF or OTF and in economically equivalent OTC contracts
- Position limits apply irrespective whether MIFiD licenced company or not
- „spot month“ and „other month“

FINANCIAL REGULATION OVERVIEW

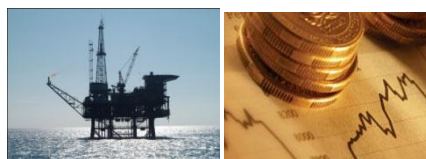


Main Business Test

Commodity
derivatives
trading*



Main
Business



ESMA proposes to use total trading in commodity financial instruments as proxy of the capital invested in the main business (!) The result of this test determines the level of the 'trading activity threshold' applicable in the second test (see below)

Market Size Test

Ratio test of Commodity
derivative trading* to Main
Business (in Gross Notional
Value)

**Commodity specific thresholds (prop trading
compared to overall EU financial trading in each
commodity class)**

	Gas, oil	Power	Coal	Freight & others	Emissions (EUAs)
<10%	3%	6%	10%	15%	20%
10%-49.9%	1.5%	3%	5%	7.5%	10%
≥50%	0.6%	1.2%	2%	3%	4%

*excluding hedging, intragroup and liquidity provision



Where we are now....

Definition of FI

- Brokers (currently NON-MTF) have to obtain OTF license otherwise physically settled gas & power contracts are in MIFiD scope
- Exchanges establish new NON-MTF trading platforms

Ancillary Activity test – new proposal of MBT

- ESMA is not willing to change RTS, ball is in hand of DG FISMA
- ESMA opinion (released on May 30):
 - Numerator – CRR approach, MtM or Initial plus Variation margin
 - Denominator - Property, Plant and equipment (PPE), Equity + long term debt (excluding provision), Equity + long term debt (including provision), Equity or Capital Employed proposed by ESMA in December 2014
- Aim of JEAG (Join Energy Association Group) - reintroducing Capital Employed Test
- Why? The capital employed test enables firms to reflect correctly the size of their main corporate business

Position limit

- Definition of „*deliverable supply*“ is not clear
- NRA and Exchanges begin to set up procedures
- ESMA – detailed guideline is needed



MAD/ MAR (in force – January 7th, 2016)

Who is in scope?

All firms and individuals who participate in regulated markets, MTFs, OTFs and OTC

What instruments are in scope?

MAR (Art 2.1)

- a) Financial instruments admitted to trading on a regulated market.....
- b) Financial instruments traded on an MTF.....
- c) Financial instruments traded on an OTF.....
- d) Financial instruments not covered by point (a), (b) or (c), the price or value of which depends on or has an effect on the price or value of a financial instrument referred to in those points, including, but not limited to, credit default swaps and contracts for difference.

Behaviour or transactions, including bids, relating to the auctioning on an auction platform authorized as a regulated market of emission allowances [..].

MAR (Art 2.2)

Spot commodity contracts, which are not wholesale energy products, where the transaction, order or behavior has or is likely or intended to have an effect on the price or value of a financial instrument referred to in paragraph 1.



Key elements for commodity industry

- Effective from July 2016
- New definition on inside information for commodity derivatives and emission allowances
- Inside information related to emission allowance has to be published as well
- MAR „over-ruling“ regulation for all other regulations (REMIT)
- Applies to any Transactions and Orders or behaviour concerning MiFID financial instruments
- Prop traders are in scope of PPAET – last ESMA Q&A May 30th, 2016
- STOR (Suspicious Transactions and Orders Report)
- Whistleblowing must be in place
- Administrative sanctions:
 - Financial – natural persons – up to EUR 5M, legal person – up to EUR 15M or 15% of annual turnover
 - Criminal penalties - natural persons – MAX 4 years for market manipulation & insider dealing, MAX 2 years unlawful disclosure of insider information



What market participants have to do....

Key elements of MAR

- **Prevention and detection of market abuse**
 - IT Systems
 - Training
 - STOR obligation
 - Definition of Inside information

- **Policies, Disclosures and Record Keeping**
 - Managers' transactions
 - Investment recommendations and statistics
 - Record keeping
 - Whistleblowing



CRD IV/ CRR (in force – January 1st, 2014)

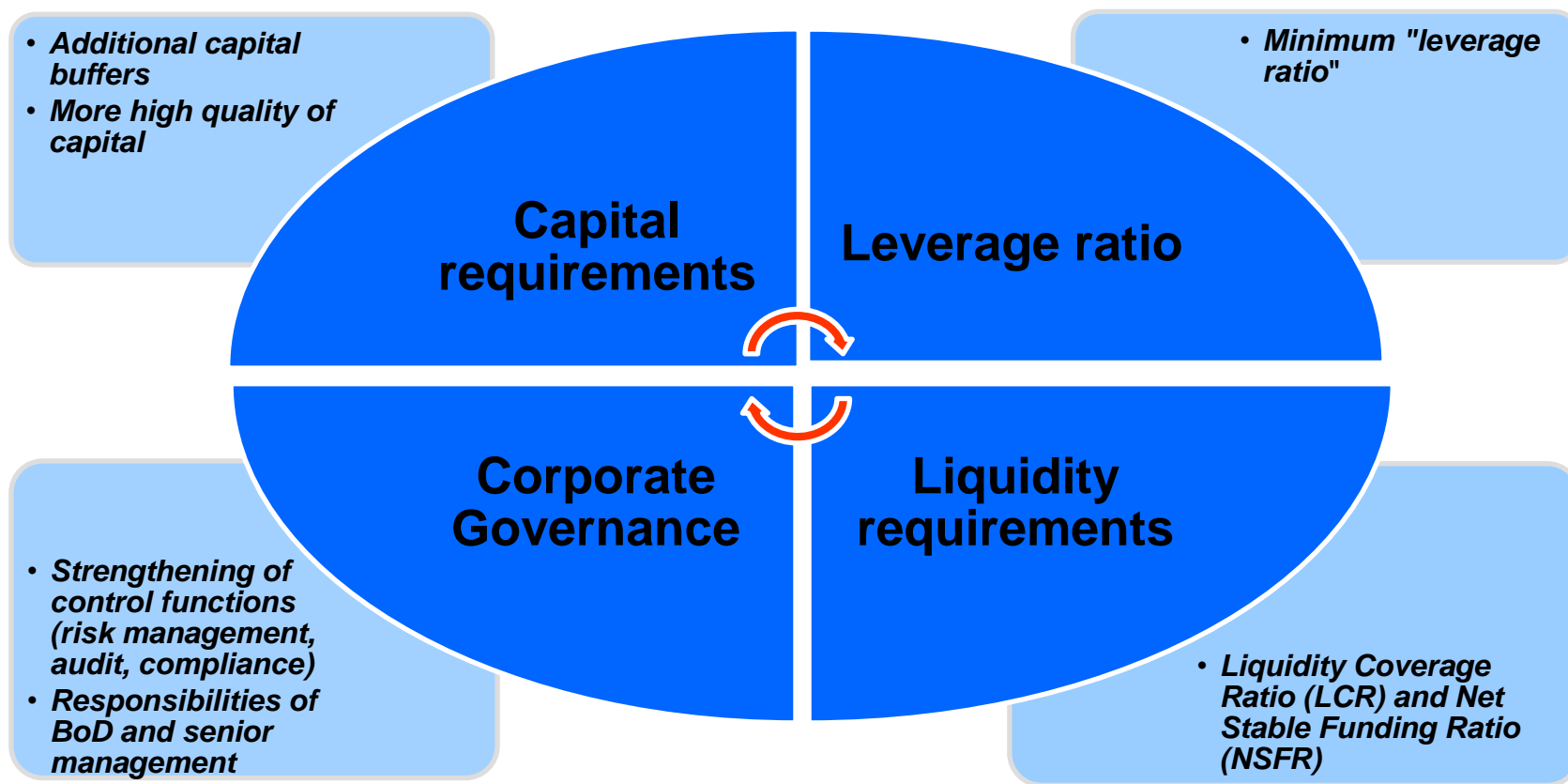
Who is in scope  **Credit institutions and Investment firms**

The Basel II capital framework

<i>Pillar 1</i> <i>Regulatory Capital</i>	<i>Pillar 2</i> <i>Supervisory Review</i>	<i>Pillar 3</i> <i>Market Disclosure</i>
<ul style="list-style-type: none">• <i>aligns minimum capital requirements more closely with institution's actual risks</i>	<ul style="list-style-type: none">• <i>provides the supervisory review of institution's internal assessments of their overall risks and capital adequacy based on those risks</i>	<ul style="list-style-type: none">• <i>motivates prudent management by enhancing the degree of transparency in institution's public reporting</i>



The Basel III* Add-on



* *Basel III = CRD IV*



Where we are now....

ESMA intention

MiFID II Consultation papers – clear signal[*the Commodity industry should be captured*](#)

MiFID and CRD implication

- Exemption for commodity dealers (CRR Art. 493 Large exposures & Art. 498 Own Funds requirements) extended to 2020 ,
-however, if the company is classified as MiFID 2 investment firm, **it has to comply with remaining CRD & CRR requirements** (i.e. reporting, public disclosure, etc.)



Other threats

EMIR (in force – January 1st, 2014)

- Under review
- Some issues from report
 - Only 43 NFC+
 - 85% of NFC- qualify 100% of their transactions as hedging
 - ESMA proposes to aggregate the position of NFC in OTC derivatives irrespective of their hedging or non-hedging nature

SFTR (in force – January 12th, 2016)

- Repo/buy-sells/lending transactions relating to securities or commodities has to be report to Trade Repositories – mid 2017

BENCHMARK (shall be adopted in summer 2016, valid approx. January 2018)

FTT (under discussion)



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Specific Risk/Impact



Compliance

MiFID → unclear which contracts and companies will be captured,

MiFID, CRD → to comply all at once

MAD/MAR → to comply



Strategic

Trading entity

P/L

Remuneration

Licencing



Cost

Personel

IT

Advisory

Cost of Capital



Liquidity

Decrease of market participants → liquidity drop

Reducing possibility to hedge



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Commodity firms are different...



No financial services

- no commercial lending
- no collecting deposits
- only wholesale counterparty



Under bankruptcy

It is possible to continue core operations



Nature of settlement

- Physical delivery
- Infrastructure asset



No systemic risk

already covered through the rules on security of supply



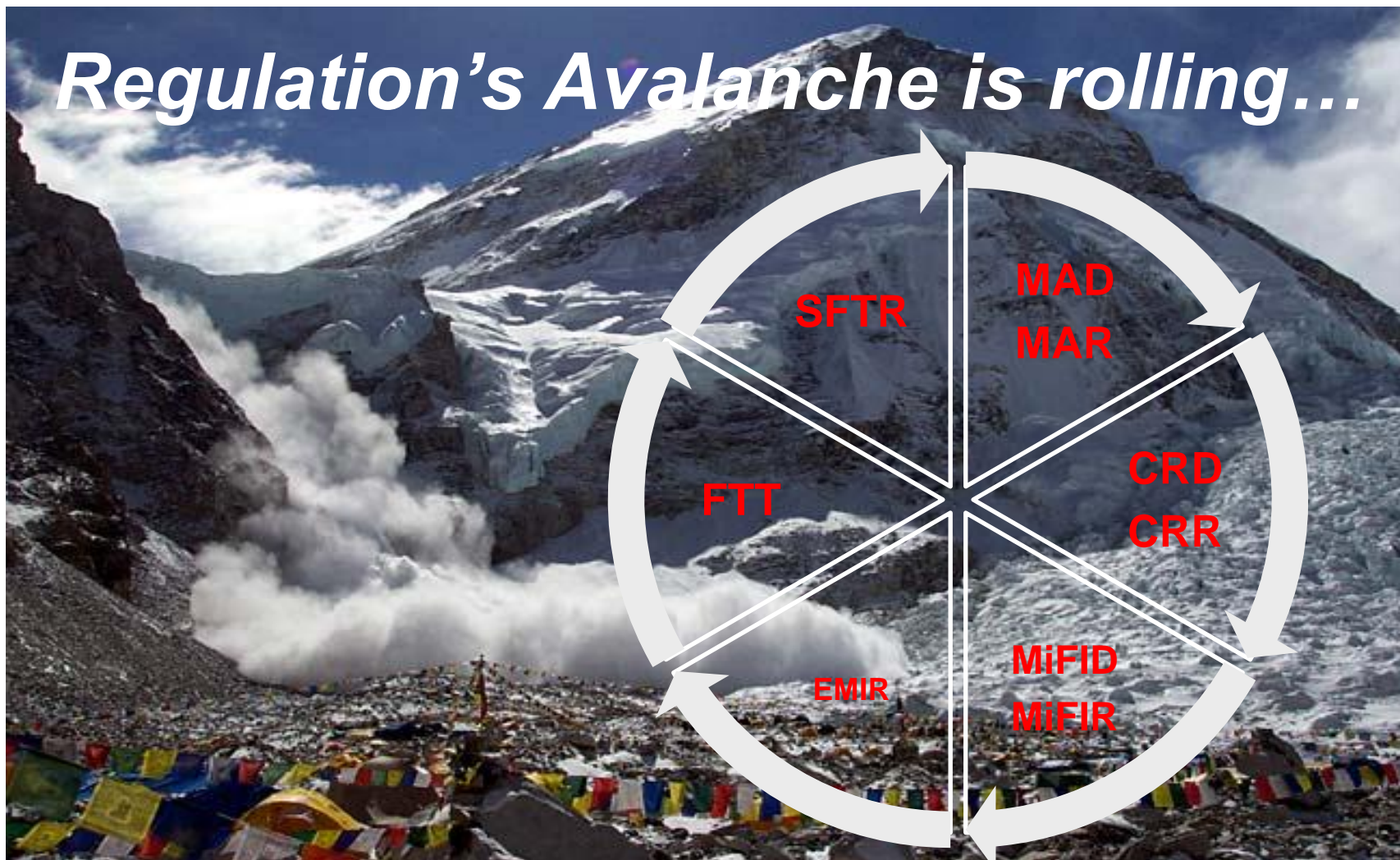
The world is becoming more complex...

Pythagorean theorem	24 words
Archimedes' Law	67 words
Decalogue	179 words
US Constitution	7 818 words
BASEL I	10 492 words
The Treaty of Lisbon	73 926 words
MiFID II/ MiFIR II	115 524 words
BASEL II	150 309 words
BASEL III - CRD IV / CRR	284 323 words

*Do we see light
at the end of
tunnel?*



Regulation's Avalanche is rolling...





Richard Koch's quote:

**“Once something becomes
complicated...
.....simplify it.
If you can not simplify it, cancel
it!”**



THANK YOU FOR YOUR
ATTENTION.

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