

Metals and Mining – the Financial Regulatory Challenges Ahead

Opening remarks

On Monday 05 October, FIA Europe and Norton Rose Fulbright LLP co-hosted a seminar titled “Metals and Mining, the Financial Regulatory Challenges Ahead.” Attendees (in person and by conference call) representing over 40 firms were welcomed by Norton Rose Fulbright partner and Head of Trade Finance Nick Grandage. FIA Europe CEO Simon Puleston Jones then gave a brief overview of the current climate for participants in the metals and mining markets which he summarised with the words “China, Volkswagen, Glencore, EMIR, MiFID 2, MAR, and CRR”. He reviewed the draft regulatory technical standards on the “ancillary activity” exemption and “position limits” for commodity derivatives recently published by the European Securities and Markets Authority (**ESMA**). He noted the far-reaching consequences for persons in scope of the Markets in Financial Instruments Directive (**MiFID 2**) expanded authorisation requirements, including mandatory clearing and margining under the European Market Infrastructure Regulation (**EMIR**), the loss of the hedge exemption and the application of the EU Credit Requirements Directive/Regulation (**CRD4/CRR**) own funds requirements and large exposure. Simon reflected on the consequences of the Volkswagen scandal for the industry, touched upon the UK “Fair and Effective Markets Review” (**FEMR**) and anticipated a potential extension of the UK Senior Managers regime.

Panel I – Mining, Metals and MiFID2 – key issues for market participants

Moderator Christiane Leuthier (Head of Commodities, FIA Europe)

Harriet Hunnable (Executive Director & Global Head of Precious Metals, CME Group)

Paul Bromley (Finance Director, Amalgamated Metal Trading Limited)

Hannah Meakin (Partner, Financial Services, NRFLLP)

Panellists briefly discussed the current EU regulatory regime for miners, merchandisers and base and precious metals consumers which - for now - permits a relatively wide range of activity. The moderator then asked for their views on changes to come via the MiFID 2 legislation, which will eliminate the broad exemptions from regulation available to market participants. Much attention was paid by panellists to the MiFID 2 ancillary activity exemption and related calculations and thresholds. The specific trading activity and market share tests proposed by ESMA were discussed at length, as well as the challenge of obtaining accurate data to perform the calculations they necessitate. More generally, panellist commented that supplying regulators with data that is not readily available is often costly and can conflict with confidentiality provisions.

The discussion moved to the cross-border and extraterritorial effects of the new MiFID regime, with panellists noting the scope of key requirements extending to bilaterally executed contracts with non-EU counterparties. Panellists spoke of the prospective differences between the US and EU position limits regime, with thousands of commodity derivative contracts subject to limits in the EU versus only 28 so-called Core Referenced Futures contracts in scope for US limits in the near term. Panellists expressed concern that the European position limit regime with its potentially long hedge exemption approval periods will be more burdensome and affect market liquidity. Panellists speculated on how the position limit regime would dovetail with current London Metal Exchange (**LME**) guidance and new LME limits for certain contracts.

Panellists then discussed capital requirements. Concerns were expressed that metals market participants may be required to hold regulatory capital against their assets and exposures similar to banks when key exemptions expire in 2017. While an extension to this exemption up to 2020 is

possible, ensuring that the post-2020 regime is proportionate for commercial firms and smaller participants via timely engagement with regulators was seen as a priority. Questions were asked by attendees on whether the 02 January 2017 MiFID 2 application date was realistic in practice and when changes to the FCA Handbook were likely. One attendee asked whether the exchanges expected a shift in market participants' behaviour in favour of exchange-traded derivatives. Panellists agreed and remarked that a bigger trend is the move towards transacting on transparent trading platforms, driven partly by market abuse considerations.

Panel II – FEMR, MAR and Benchmarks – the new market abuse regime

Moderator Conor Foley (Head of Government and Regulatory Affairs, NRFLLP)
 Sakhila Mirza (General Counsel, London Bullion Market Association)
 Richard Baker (Chief Executive Officer, Cleartrade Exchange)
 Philip Howard (Head of Compliance - Freepoint Commodities Europe LLP)

The moderator commenced discussion on FEMR and sketched its possible consequences, such as a regulatory regime for spot FX including bullion transactions or the extension of the FCA's Senior Managers and Certification regimes. Panellists agreed that the FEMR report was a "common sense" summary for firms, essentially urging them to "do the right thing". Panellists considered that cooperation with the FEMR team had been fruitful and that if certain unique characteristics of physical and commodity derivatives markets could be demonstrated to regulators, a differentiated approach under FEMR was possible.

The moderator then questioned panellists on the new EU Market Abuse Regulation (**MAR**). Panellists discussed the overhaul in the trading derivatives as well as the use of benchmarks, precious metal derivatives and trading in the metals underlying these contracts under the new regime. Panellists discussed how to educate front office staff as to regulatory requirements, with one panellist commenting that the key question is simple: "should you be on the front page tomorrow, could you justify what you have done?" Panellists also spoke of challenges for smaller market participants in understanding and surveilling the nexus between 'physical' and 'financial' in MAR, for instance the manipulation of the physical market to influence the financial in spot commodities or spot forward contracts. Panellists assessed that while banks are very aware of MAR and have adequate resources for training, refiners and others might not be as familiar with the changed regime. Many traders still think spoofing under the EU regulation on energy market integrity and transparency (**REMIT**) is acceptable, with some not even aware they are trading in financial instruments when putting bids and offers into physical markets, they suggested. The rules could be summarized as follows, one panellist said: if you benefit from market movements, that is acceptable. If you intentionally cause a move in those markets to benefit from, that is not.

Panellists next discussed the challenges in detecting market manipulation under the new regime. Panellists said that defining insider information in commodity markets, bar perhaps power, is extremely complicated. Setting price limit rules on a daily basis could also be a challenge, especially with more volatile contracts. One panellist said that while exchanges are expected to detect manipulation through trading activity, order to trade rules, monitoring cancelled and modified orders and so forth, this is difficult to manage as long as MiFID 2 does not yet apply.

The moderator turned discussions to new legislation on commodity and financial benchmarks. While this legislation was triggered by the abuses and failings of financial benchmarks, panellists remarked that the impact on base and precious metal benchmarks and contracts referencing benchmarks would be significant. Panellists suggested that some benchmarks were unlikely to survive the new regulatory regime, and that benchmarks that remain available will change considerably. Due to changes in the regulatory regime, panellists saw a reduced appetite amongst market participants to contribute to benchmark surveys.

The discussion moved to Asia and whether regulators in the UK and in Singapore held different expectations of market participants. Panellists agreed that there is no excuse for ignorance when it comes to MiFID 2 and that in any case, Singapore is tracking MiFID 2 closely. One panellist said it is a

challenge ensuring contracts are relevant to consumers and that market operators must be careful not to design themselves out of the market.

Attendees questioned the panel as to the liquidity effects of any crack down on perceived market abuse in commodity derivative markets and discussed the challenges for market participants to 'read the regulator' on permissible trading activity.

Questions and comments

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