MiFID II Briefing on Non-Financials Topics

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Position limits	Hedging exemption
Ancillary activities thresholds	

1. Ancillary Activities thresholds: chapter 6, RTS 20

All participants in commodity derivatives markets should be subject to appropriate regulation and supervision. Therefore ESMA sets quantitative tests to assess whether a non-financial firm's speculative trading activities are so great it should be authorised as a financial firm. A non-financial firm must be below the thresholds for both tests to be exempt from MiFID II.

The **"market share"** test considers whether a firm's speculative trading in commodity derivatives is high in relation to overall trading in the EU market. Hedging transactions, plus some other types of transactions, are not taken into account so these thresholds apply only to what trading non-financial firms do on top of transactions permitted for their main business. Thresholds are set at:

Metals	Oils/oil products	Coal	Gas	Power	Agriculture	Other, incl. freight	Emission Allowances
4%	3%	10%	3%	6%	4%	15%	20%

The **"main business"** test measures a group's speculative trading in commodity derivatives as a percentage of its total commodity derivatives trading. Here, the total trading, including hedging activity in particular, is used as a proxy for the main business of the non-financial entity. The threshold is set at 10%.

As hedging activity is not wholly accurate as a proxy for a group's main business, ESMA introduces a back-stop to ensure the tests capture sizable participants only.

- If a firm's speculative trading activity is 10-50% of its total trading, it may be MiFID II exempt providing its market share is less than 50% of each threshold in the market share test e.g. 2% for metals, 1.5% for oil etc.
- If a firm's speculative trading activity is above 50% of its total trading, it may be MiFID II exempt providing its market share is less than 20% of each threshold in the market share test e.g. 0.8% for metals, 0.3% for oil etc.

A firm should calculate a simple average of three years on a rolling basis once three years of data are available. Until this time, interim periods apply.

2. Position Limits: chapter 6, RTS 21

To improve the transparency and functioning of the commodity markets, ESMA proposes spot month position limits are based on deliverable supply and other months' limits are based on total open interest. Limits for securitised commodity derivatives, however, will be based on a percentage of the instruments in issue. The position limits' range is 5% to 35% with a special regime for new and illiquid contracts: where open interest is below 10,000 lots, the position limit is 2,500 lots. ESMA will publish its draft rules on position reporting by end of 2015.

3. Hedging Exemption: chapter 6, RTS 20 and 21

To ensure non-financial firms can continue economic activity directly related to their main business, only non-hedging activity counts towards the ancillary activity tests and positions under the position limits regime. ESMA defines hedging in line with the EMIR definition and requires a firm to demonstrate some linkage between transactions and its hedging position to ensure it is used consistently and appropriately.

MiFID II timeline