

# Lobbying MEPs on MiFID

Briefing for local groups, updated April 2012

*This briefing is designed to give you more information about the Market in Financial Instruments Directive (MiFID) to help your local WDM group prepare for lobby meetings or other events with your MEP. Please do not forward this briefing to your MEP as we will be preparing further information for MEPs with details of proposed amendments as the regulatory process in the European parliament develops.*

*In response to requests from some WDM group members, we are providing quite a high level of technical detail. Please note that **it is not necessary to be familiar with or fully understand all this information before meeting with your MEP.***

## **About MiFID**

The Markets in Financial Instruments Directive (MiFID) is an existing piece of European legislation which covers investment in a whole range of financial products and services. The directive came into force in 2007, just before the financial crisis, and led to a deregulation of stock markets.

Now the directive is being reviewed. Within the new proposals are provisions to regulate the commodity derivative markets, where food speculation occurs. Our campaign is focussing on these parts of the legislation.

The new legislation will consist of two parts: a revised directive (MiFID 2) and a new regulation (MiFIR). The regulation will be binding and should lead to greater consistency across Europe as it will be applied directly to all member states. The directive must be translated into national law in each of the member states.

## **The process for MiFID**

Three European institutions are involved in the review of MiFID. In October 2011 the commission published its proposals for the new legislation. It will now be considered by the MEPs in the European parliament, and finance ministers from each of the EU member states who form the Council of Ministers.

In the European parliament, the process started with a public hearing in December 2011, where representatives from different groups of stakeholders gave evidence to the economic and monetary affairs (ECON) committee, which has responsibility for scrutinising the proposals.

The lead MEP (rapporteur) for this legislation is a German conservative MEP, Markus Ferber. He has produced draft reports setting out MEPs' views on MiFID and MiFIR, which were published in March 2012. He has used a questionnaire to canvas opinions on the proposals which closed on 13 January. WDM submitted a detailed response to the questionnaire as well as coordinated a petition with other European groups with over 8000 signatures being submitted.

MEPs on the ECON committee be able to table amendments until early May, with voting taking place in July before MEPs break for summer recess. Following the committee stage, all MEPs will have the opportunity to vote on the proposals – we expect this to happen in late 2012 or early 2013.

Once the legislative process is concluded, the new rules in the regulation would apply almost immediately after publication of the agreement. The new directive will need to be implemented in member states during 2013 and 2014.

## **European parliamentary committees**

The ECON committee has responsibility for the review of MiFID in the European parliament, so MEPs that sit on this committee are particularly influential. We have already been in touch with groups who are based in these MEPs' constituencies.

In addition, two other committees will have opportunity to give their opinions on the proposals. These are the development (DEVE) and industry, research & energy (ITRE) committees.

## The proposals in detail

The commission's proposals for the new rules would see some progress in the areas we've been campaigning on, but currently they are too weak to adequately curb financial speculation on food prices.

In the sections below, we explain what has been proposed by the commission, and where we think the proposed rules need to be strengthened. Where we refer to specific articles (rules), we specify whether they are part of the regulation (MiFIR) or directive (MiFID) as well as giving the article number.

We have also added and amended information where the draft reports produced by Markus Ferber have recommended changes. These additions are given in light grey type.

### Exchange trading

Most commodity derivative contracts are being traded behind closed doors with no publicly available information on these deals. This is called 'over the counter trading.' We are calling for all commodity derivative contracts to be cleared through regulated trading venues or exchanges ('exchange trading'). An exchange is a public venue where traders can buy and sell contracts. In London, stocks and shares are traded on the London Stock Exchange; some commodity derivatives are traded on Euronext Liffe exchange.

#### *MiFID says:*

Currently the commission's proposals in Regulation Article 24 requires commodity derivatives to be traded on 'regulated trading venues' i.e. exchanges. However Regulation Article 26 says that the derivative must already be traded on an exchange somewhere and they must be sufficiently liquid (traded above a certain volume).

#### *WDM analysis:*

These conditions mean that there is a risk that traders could be allowed to carry on with opaque and unregulated 'over the counter' (OTC) trading outside of exchanges.

#### *What needs to change:*

To stop this happening, we recommend that the proposals in Regulation Article 26 should include clear targets for moving OTC trading on to regulated trading venues (or mandate ESMA, the European financial authority, to produce targets).

### Position reporting

We are calling for all traders to provide information on the number and type of contracts they hold ('position reporting').

#### *MiFID says:*

The proposals in Directive Article 60 call for position reporting. However, as the rules are currently written, there is a risk that different definitions could be used in different countries.

#### *WDM analysis:*

Without ensuring consistency across the EU, it would be difficult or impossible to compare the data from different countries, and allowing big traders such as Cargill to cover up speculative activities.

#### *Ferber's report says:*

ESMA must compile and publish a weekly report covering the whole of the EU.

#### *What needs to happen:*

The amendment made by Ferber should be retained.

### Position limits

We are calling for set limits on the contracts that individual companies and sectors of traders (such as financial speculators) can hold ('position limits').

#### *MiFID says:*

Directive Article 59 enables position limits to be used in individual countries, while Regulation Article 35 allows ESMA to intervene if member states don't use position limits (or alternative arrangements) when they should.

#### *WDM analysis:*

There are a number of problems with the proposals: Directive Article 59:

- It says that position limits should be applied by trading venues (exchanges). However, exchanges depend on trading to make money, creating a conflict of interest associated if they are required to limit the amount of trading.
- The proposals allow for "alternative arrangements with equivalent effect, such as position management with automatic review thresholds" instead of position limits. In the UK, position management has in practice meant deregulation.
- It says that position limits can be used to "support liquidity", which could mean maintaining or increasing the amount of trading that goes on, rather than reducing damaging speculation.
- At the moment it doesn't say that position limits can or should be used to prevent excessive speculation.
- There is no provision for aggregate limits (rather than limits on individual traders) to be used to prevent a particular category of traders (such as financial institutions) having undue influence over the market.
- It says that "national authorities are not allowed to impose limits or alternative arrangements which are more restrictive than those set out by the

commission". We're concerned that this could lead to a race to the bottom of weak regulation, as the commission is only allowed to act if member states fail to (see below).

#### Regulation Article 35:

- ESMA is only allowed to intervene temporarily. If there are on-going failures at a national level, we think they should be allowed to act on a permanent basis.
- The conditions don't allow ESMA to intervene to address excessive speculation.
- The conditions say that they shouldn't reduce liquidity – but position limits cap the amount of contracts that traders can buy or hold, which could reduce liquidity.

#### *Ferber's report says:*

- All countries must use position limits. Other arrangements like position management may be used as well, but this must be in addition to limits.
- In applying position limits, a distinction should be made between trading that is done to hedge risk, and other trading (i.e. speculation).
- The limits should be decided by ESMA.
- The restriction that would have prevented countries being more restrictive if they thought it necessary is removed.

#### *What needs to happen:*

##### Directive Article 59:

- Ferber's amendments should be retained
- The condition that position limits should be used to "support liquidity" should be amended to "support liquidity as necessary for genuine hedging activity".
- A further clause should be included to ensure position limits are used to "prevent excessive speculation from disrupting the price discovery function for the underlying commodity markets or reducing the ability of commercial participants to adequately manage their risk".
- Provision limits on categories of traders should be included.

#### Regulation Article 35:

- ESMA must be allowed to intervene permanently as well as temporarily.
- The conditions for ESME to act to include preventing excessive speculation.
- Regulation Article 35 (3c) which states that liquidity shouldn't be reduced should be removed

## Exemptions

It is important that all speculators are covered by the new legislation, with no loop holes.

#### *MiFID says:*

The first section of the proposals for MiFID (Directive Articles 2 and 3) set out exemptions for certain types of institutions.

#### *WDM analysis:*

We have the following concerns about the way this section is currently written:

- The current proposals are very unclear. It's not currently clear which traders would be exempt, and what they are exempt from.
- There is a risk that exemptions for 'commercial end users' (companies that trade real food or other commodities, such as Cargill) could allow them to speculate in the way that banks and hedge funds do, as well as using the markets to protect themselves from fluctuations in the prices of real commodities.
- Currently pension funds are exempt. Pension funds invest huge sums of money in these markets through commodity index funds without having any involvement in the physical commodity markets, and so should not be exempt.

#### *What needs to change:*

- We need clarification of exactly who would be exempt, and confirmation that they are not exempt from measures such as position limits, which apply to exchanges rather than traders.
- Exemptions for commercial end users should be amended so that they are only exempt on a case-by-case basis, and only as far as necessary to enable them to protect themselves from the commercial risk associated with the trading of commodities.
- The exemption for pension funds should be removed.

## What to ask your MEP

The most important thing is to let your MEP know that you are concerned about financial speculation on food, and that you want them to support measures to properly regulate the commodity derivative markets where this speculation occurs.

If they are supportive, you can ask them to:

- Keep you updated on the progress of MiFIR and MiFID.
- Raise your concerns with their colleagues, particularly those on the ECON committee and the other committees that will be giving their opinions (see above).
- Find out if they have been lobbied by other people about this – for example the financial sector.
- Support the relevant amendments, including those made by Markus Ferber, when the time comes (we will provide more information nearer the time).

## The precautionary approach and the EU

The precautionary principle is widely used by policy makers to protect people and the environment, and is enshrined in the Lisbon Treaty, forming part of the EU's legislative approach which has been used for decision-making on food-related issues such as food safety and GM. It states that where activities may lead to morally unacceptable harm, which is plausible but uncertain, action should be taken to avoid or diminish that harm.

There is a general consensus in the evidence that speculation can affect food prices, with negative human impacts. The 2011 Food Outlook by the UN Food and Agriculture Organisation (FAO) and the Organisation for Economic Co-operation and Development (OECD) notes that, "Almost all researchers agree that non-commercial [i.e. financial] participation in futures markets may amplify price movements in the short term."

However, this consensus continues to be challenged by the financial sector, who directly profit from speculation, and the UK government, who are heavily lobbied by the City. But even if decision makers are unable to conclusively prove the quantitative impact of speculation on food prices because of poor data due to lack of transparency in the commodity derivative markets and the complexity of the food system, the potential for food speculation to cause poverty, hunger and ill-health and the fact that there are no clear advantages to increased speculation beyond a financial elite, means that a precautionary approach should be pursued.

Because the precautionary principle is used in European legislation, it is one European parliamentarians are familiar with. For this reason, you may find it useful to refer to when lobbying MEPs.

## More information

We hope that this information will be helpful in helping you prepare for meeting your MEP. If you have any questions, we are happy to answer them over the phone or via email. For more information about food speculation or lobbying your MEP, please contact Christine Haigh at [Christine.haigh@wdm.org.uk](mailto:Christine.haigh@wdm.org.uk) or on 020 7820 4900.

For help linking up with other groups for your lobbying or to feedback on your lobbying, please contact Katharine Talbot at [Katharine@wdm.org.uk](mailto:Katharine@wdm.org.uk) or on 020 7820 4900.