



gfma

ISDA

Safe,
Efficient
Markets



LBMA

29 August 2018

Joint FIA, GFMA and LBMA response to the IOSCO Consultation Report on Commodity Storage and Delivery: Good or Sound Practices

We appreciate IOSCO's desire to engage with market participants regarding the development of good or sound practices. We welcome the report and support IOSCO's efforts to harmonise good practices in the commodity space. Particularly, where such proposals strike a commercially practical balance: (i) that recognises that the nature of the commodity or commodity class largely dictates the storage and warehousing practices for a given commodity derivative contract; and (ii) fosters improved commodity market integrity and efficiency.

Our members feel that further clarity is required regarding some aspects of the Consultation Report, as set out below.

General – Definitions and Scope

We would welcome further feedback regarding the aim of the Good or Sound Practices, i.e. is the intention to tighten physical storage practices or to lower the potential for physical commodities to impact the associated commodity derivatives?

We note that "commodity" or "commodity derivative", term also used in the 2016 IOSCO paper on commodity storage, are not defined. Should these terms be interpreted in line with MiFID II, Dodd Frank or any other legislation? It would be helpful to clarify the definition.

In addition, the Consultation Report seems to focus on base metals and agricultural markets when referring to "storage" and "warehouse" or "CCPs" and "exchanges". Will the Good or Sound Practices also apply to other commodities, for example precious metals markets? The definition of "RSI" does refer to vaults but the remainder of the paper does not seem to. We would recommend clarifying what is meant by vaults and which markets are relevant.

Commodity derivatives can be listed on a trading venue or OTC. Does the Consultation Paper aim to reduce the pricing impact on listed derivatives or also OTC contracts? It may be challenging to apply the proposed good practices to OTC derivatives due to their bilateral relationship. Further, would the good practices apply to depositories that act in a custodial capacity for an exchange as opposed to the OTC market?

The Consultation Report does not refer to existing global or regional Codes of Conduct, e.g. the Precious Metals Code. Our members feel that existing codes of conduct should be considered to avoid a duplication of efforts of conflicting good practices.

Finally, our members would welcome further clarity on the implementation and enforcement aspects of the Good or Sound Practices. We note other IOSCO Principles, for example the Principle for Financial Benchmarks, have been implemented in conjunction with respective National Competent Authorities (NCAs) or other global equivalents, with market participants required to attest compliance. Would IOSCO envisage a similar, consistent, approach to this? Equally, would there be similar sanctions or penalties for non-compliance?

Chapter 4 - Oversight

Chapter four of the consultation report addresses oversight and includes a suggestion for financial regulators to have “direct oversight” of physical commodity infrastructure or storage. As IOSCO points out, such legislation would represent a significant extension of the role of financial regulators and is beyond the remit of Good or Sound Practices. We therefore recommend IOSCO to exercise caution on this point and suggest deleting on page 6 and 7 the paragraph *“In jurisdictions where the legal framework permits it, legislative bodies could consider granting express direct oversight of RSIs....to directly supervise the many and varied types of storage infrastructures”*.

We do not believe that IOSCOs proposals to advocate for the introduction of sanctioning powers (via regulators) requiring either trading venues or CCPs to sanction Relevant Storage Infrastructures (“RSIs”) for action or inaction compromising market integrity will materially assist in the enhancement of good and sound practices for commodity delivery and storage infrastructures. Many elements of physical infrastructure are already subject to existing regulation or guidelines. For example, trading venues such as the LME, ICE or Comex have established rules and good practices that warehouses and storage providers need to follow in order to remain an approved storage location. In addition, those structures are subject to local legislation. Those who do not follow the exchange rules can be de-listed or removed from the list of approved storage providers. Further, (i) many exchanges / CCPs and venues already have established dispute mechanisms in place; (ii) delays could be caused by interpretive disputes around the codification of such powers; (iii) there is a potential for increased cost due to implementation and system builds for the compliance with any new requirements; and (iv) they can lead to legal uncertainty as a result of duplicative rulesets.

In precious metals markets, the London Bullion Market Association (LBMA) sets standards for the physical metal delivered into, and vaulted by, its members. It defines rules on weighing procedures as well as transportation, packaging and storage practices. In conjunction with its members and London Precious Metals Clearing Limited (LPMCL) the process of establishing safe and secure vaulting facilities has been established.

Our members thus disagree with IOSCOs statement on page 7 of the Consultation Report that there is a lack of clarity over the rules of the trading venue, CCP or other over extra-territorial RSIs and would like IOSCO to expand by providing examples where they see a gap.

Recommending additional legislation or direct regulatory oversight by a regulator would subject those active in physical commodity markets to additional and possibly duplicative or conflicting regulation. We strongly recommend including language which seeks to ensure any new regulatory oversight is harmonised with existing regulation and codes of conduct. In addition, IOSCO may wish to consider the impact of additional costs to the industry in implementing and adhering to new regulation arising from financial regulators.

Chapter 5 - Transparency

We support transparency in relation to RSIs and our members note that a number of trading venues already publish regular stock reports, e.g. the LME and the LBMA on vault storage.

Further, IOSCO may wish to consider adding further detail on information handling and sensitivity of holding information, e.g. who has access to storage, movement or client holding information, and how it is used. Another aspect of transparency could be the management of information relating to the physical commodity that could impact the related commodity derivative.

Chapter 6 – Fees and Incentives

The Consultation Report on page 11 states that participants should be free to enter commercial negotiations to set an appropriate storage rental rate within the boundaries of any fee-charging rules or guidelines set by trading venues. Our members emphasise that the key point is a consistent application of fees across market participants, i.e. dependent on a number of factors but commensurate to the client or counterparty and service being performed.

IOSCO proposals suggesting that Relevant Oversight Bodies (“ROBs”) require that RSIs establish a fee structure that incentivise on-time delivery e.g. the settlement and paying of “load out” fees after load out. Whilst we welcome proposals that promote on-time delivery, a bifurcation of payment (as suggested in paragraph 3 on page 11 of the paper) would currently conflict with LME rule requirements around FOT (Free on Truck) charges, which currently must be settled in full upfront. A practical alternative to such a proposal could be to propose guidelines that advocate discounting of such FOT or warehousing fees where there are delays.

We note the proposals advocating that storage fees are collected and distributed by trading venues rather than warehouses. Given the overriding objective of the Consultation Report is to advocate sound practices within a market framework that incentivises market best practice and self-correction, rather than prescriptive rule making, we advocate that direct relationships should be maintained with the warehouses rather than the trading venues, with regard to the collection and distribution of storage fees. For practically sufficient oversight currently already exists with warehouses submitting “rent deals” to exchanges for oversight (e.g. LME). This strikes a balance between providing transparency for such arrangements whilst recognising commercial sensitivities around the provision of warehousing services.

Appendix 1 – List of Good or Sound Practices

Oversight

8th bullet point: Other than de-listing or removing a storage infrastructure from a list of approved providers, our members question whether establishing a requirement for sanctions with extra-territorial effect is legally permissible and enforceable under the local law of the storage infrastructure?

15th bullet point: We recommend removing this point as direct oversight by financial regulators is outside of the remit of the Good or Sound Practices.

17th bullet point: We believe it may be legally challenging to require RSIs to consent to the jurisdiction of the same financial regulator as the trading venue, such recommendation may conflict with local laws and enters the space of cooperation between regulators and equivalence.

19th bullet point: Whilst our members support increased information sharing, the reference to direct oversight by one ROB over a RSI in a different jurisdiction raises the same issues as those mentioned under bullet point 17 and we recommend deleting or amending this good practice accordingly.

Transparency

13th bullet point: Should it be clarified whether the disclosure of fees is restricted to those fees associated with any exchange registered or delivered product?

Fees and Incentives

5th bullet point: Our members note that asking the trading venue or clearing firm to collect storage fees may not always be practicable or possible as often exchanges and brokers are not party to the payment process. This would also apply to any exchange delivery where the two parties to the delivery agree to an ADP process.

Conflicts of Interest

2nd and 6th bullet points: The use of “may” should be amended into “should” as different types of market participants depend on an effective framework and thus the approach to conflicts of interest should be as harmonised as possible. The relevant bullet points should thus read:

“Financial regulators should set requirements that the rules of the trading venue which cover RSI [infrastructure/storage] arrangements address conflicts of interest...”; and

“Trading venues or CCPs should require that RSIs disclose to them any legal or beneficial relationships with market participants that are associated entities.”

Operations

1st bullet point: Our members are concerned that data on the ownership (i.e. identity of the owner) may be proprietary and confidential information or be subject to an expectation of commercial anonymity. Any rules requiring disclosure of commercially sensitive information may be subject to legal challenge both in the jurisdiction of the ROB as well as the RSI.

About FIA

FIA is the leading global trade organization for the futures, options and centrally cleared derivatives markets, with offices in Brussels, London, Singapore and Washington, D.C. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries as well as technology vendors, lawyers and other professionals serving the industry. FIA’s mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system, and promote high standards of professional conduct. As the principal members of derivatives clearinghouses worldwide, FIA’s member firms play a critical role in the reduction of systemic risk in global financial markets. For more information please visit www.fia.org

About GFMA Commodities Working Group

The Commodities Working Group of GFMA focuses on regulatory issues specific to banks operating in the financial and physical commodities markets. The CWG’s work centers around the creation of a more level regulatory playing field for the commodity markets, advocating consistency and avoiding duplication among legislative measures.

The Global Financial Markets Association (GFMA) brings together three of the world’s leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong

Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, visit <http://www.gfma.org>.

About ISDA

Since 1985, the International Swaps and Derivatives Association has worked to make the global derivatives markets safer and more efficient.

ISDA's pioneering work in developing the ISDA Master Agreement and a wide range of related documentation materials, and in ensuring the enforceability of their netting and collateral provisions, has helped to significantly reduce credit and legal risk. The Association has been a leader in promoting sound risk management practices and processes, and engages constructively with policymakers and legislators around the world to advance the understanding and treatment of derivatives as a risk management tool.

ISDA has over 900 member institutions from 68 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers.

ISDA's work in three key areas – reducing counterparty credit risk, increasing transparency, and improving the industry's operational infrastructure – show the strong commitment of the Association toward its primary goals; to build robust, stable financial markets and a strong financial regulatory framework.

About LBMA

LBMA is the pre-eminent standard-setting body for the global wholesale market for precious metals.

The role of LBMA is key to helping the market operate against a fair and effective framework. LBMA plays a fundamental role in accrediting its members and providing for quality assurance. This is through the maintenance and further development of the Good Delivery List, the Responsible Sourcing Programme, the Global Precious Metals Code, and the ownership of the precious metals benchmarks.

For more information on LBMA, please visit www.lbma.org.uk.