



29 November 2019

**GFMA Commodities Working Group response to ESMA's consultation on the MAR Review (ESMA 70-156-1459)**

**Introductory comments**

- GFMA CWG welcomes the opportunity to respond to the consultation launched by ESMA on the review of the Market Abuse Regulation (MAR).
- GFMA CWG supports the regime which EU legislators introduced in 2014 to tackle insider dealing in commodity derivatives (and spot commodity) markets. We do not see a need to change this regime.
- GFMA CWG understands that ESMA may seek simplification of the regime and contemplate further alignment between the regime applicable to securities markets and that for commodity derivatives markets. However, we strongly believe that such alignment is not appropriate and that the reasons for separate definitions of inside information are still valid.

We have answered questions 6, 13, 16, 17, 18 and 19, below.

**DEFINITION OF BENCHMARK IN MAR (Q6)**

*Q6: Do you agree that Article 30 of MAR points (e), (f) and (g) should also make reference to submitters within supervised contributors and assessors within administrators of commodity benchmarks?*

We do not consider it appropriate for Article 30 MAR points (e), (f) and (g) to refer to submitters within supervised contributors and assessors within administrators of commodity benchmarks. The purpose of Article 30(e), (f) and (g) is to ensure that if a director or other manager of a firm oversees a business which breaches MAR, they should be banned (temporarily or permanently) from exercising management control over another investment firm (under (e) and (f)) or from dealing on own account (under (g)).

The prohibition on dealing on own account does not seem to be relevant to benchmark submitters or assessors, as their breach would not relate to control of inside information or market manipulation.

In relation to points (e) and (f), while a person discharging managerial responsibilities will be someone senior within an investment firm, the same will not necessarily be true of a benchmark submitted or assessor. If they are sufficiently senior that they are a person discharging managerial responsibilities, then they are already covered by points (e), (f) and (g). If they are not senior enough to be a person discharging managerial responsibilities then it seems inappropriate to hold them responsible for the breaches of the institution that employs them.

## DEFINITION OF INSIDE INFORMATION (Q16/17/18/19)

### 5.1.2.1 Inside information for commodity derivatives

*Q16: Have market participants identified inside information on commodity derivatives which is not included in the current definition of Article 7(1)(b) of MAR?*

No, we have not identified information on commodity derivatives which could be considered to be "inside information" on commodity derivatives but which is not included in the current definition of Article 7(1)(b) MAR.

*Q17: What is an appropriate balance between the scope of inside information relating to commodity derivatives and allowing commodity producers to undertake hedging transactions on the basis of that information, to enable them to carry out their commercial activities and to support the effective functioning of the market?*

*Q18: As of today, does the current definition of Article 7(1)(b) of MAR allow commodity producers to hedge their commercial activities? In this respect, please provide information on hedging difficulties encountered?*

We consider that the current definition of inside information in Article 7(1)(b) MAR provides for an appropriate balance, and that it allows commodity producers and other commodity market participants to hedge their commercial activities.

In particular:

- Recital 20 MAR provides that it is not appropriate or practicable to extend the scope of MAR to behaviour that does not involve financial instruments, for example, to trading in spot commodity contracts that only affects the spot market.
- The specific definition in Article 7(1)(b) MAR for inside information in relation to commodity derivatives enables commodity producers and other commodity market participants to undertake hedging transactions by specifying that information will only be "inside information" in relation to commodity derivatives where it is reasonably expected to be disclosed or required to be disclosed in accordance with legal or regulatory provisions at the EU or national level, market rules, contract, practice or custom, on the relevant commodity derivatives markets or spot markets.

This additional criterion in relation to commodity derivatives is important because of the differences between the circumstances in which inside information may arise in relation to securities (i.e., in relation to the relevant instruments or in relation to the issuer of those instruments) and the circumstances in which inside information could arise in relation to commodity derivatives without this additional criterion. Most importantly, without this additional criterion, inside information could arise in relation to either party to a commodity derivative contract, meaning that the parties could no longer trade and posing a significant barrier to hedging activity and to the effective functioning of the market.

*Q19: Please provide your views on whether the general definition of inside information of Article 7(1)(a) of MAR could be used for commodity derivatives. In such case, would safeguards enabling commodity producers to undertake hedging transactions based on proprietary inside information related to their commercial activities be needed? Which types of safeguards would you envisage?*

We do not consider that the general definition of inside information in Article 7(1)(a) MAR could be used for commodity derivatives.

If the general definition of inside information in Article 7(1)(a) MAR was applied to commodity derivatives, it would mean that a vastly wider range of information would become "inside

information" in relation to commodity derivatives than in relation to other financial instruments. Since the disclosure requirement in relation to inside information only applies to issuers, with other persons being restricted from disclosing information under Article 10 MAR, this very broad definition of inside information could lead to significant disruption of the commodity and commodity derivative markets.

For example, non-public information about a particular mine or refinery, about disruption of deliveries due to weather or other factors, or about the financial situation of a significant market participant could be precise, non-public and price sensitive in relation to a particular commodity derivative contract. The parties to a commodity derivative contract would not be able to cleanse themselves by disclosing this information (as they are restricted from doing so under Article 10 MAR and, in contrast to the securities markets, there is no "issuer" who is required to disclose this information to the market). If there is no requirement to disclose this information then it is unlikely that it would be disclosed publicly in many cases as it may not be in the commercial interests of the affected entity to disclose the information, and other market participants may not be permitted to disclose the information (e.g., because this may breach confidentiality obligations or may involve litigation risk). As a result, in contrast to the securities markets where non-public information relating to the issuer will be disclosed periodically by the issuer, cleansing the market and enabling trading to resume, in the commodity markets a counterparty to a derivative could potentially be in possession of inside information indefinitely and would not be able to trade at all until the information somehow becomes public.

The existing provision in MAR Article 7(1)(b) clarifying that information in relation to commodity derivatives is only inside information "where this is information which is reasonably expected to be disclosed or is required to be disclosed" in accordance with legal or regulatory provisions, market rules, contract, practice or custom is aimed at addressing this problem and currently operates to give clarity to the market while also protecting effectively against misuse of non-public information.

Prohibiting counterparties to commodity derivatives from trading while in possession of this information, and while unable to cleanse themselves, would materially affect the ability of commodity producers and other commodity market participants to hedge their exposures and would have a significant impact on the effective functioning of these markets.

There are many other examples that we could provide to ESMA if this would be helpful.

MAR (and its predecessor, the Market Abuse Directive<sup>1</sup>) protects commodity derivative market participants and avoids these difficulties arising in relation to commodity derivatives by making a distinction between inside information in relation to securities and in relation to commodity derivatives.

If this distinction was removed, it would be necessary to introduce safeguards to replicate this protection and to enable commodity producers to undertake hedging transactions based on proprietary inside information related to their commercial activities and to protect other commodity spot and derivative market participants.

One way to do this would be to create a new safe harbour (e.g., where a person in possession of inside information places orders or enters into transactions for the purposes of hedging activity). However, any safe harbour would only relate to the prohibited activities of insider dealing and unlawful disclosure – it would not change the fact that a much wider range of information would become "inside information" and therefore any person dealing in commodity derivatives would need to have

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<sup>1</sup> Article 1 of Directive 2003/6/EC stated that "in relation to derivatives on commodities, "inside information" shall mean information of a precise nature which has not been made public, relating, directly or indirectly, to one or more such derivatives and which users of markets on which such derivatives are traded would expect to receive in accordance with accepted market practices on those markets".

systems in place to identify and monitor relevant information and ascertain before trading that each transaction falls within the safe harbour. Given the fact that insider dealing is a criminal offence in most EU jurisdictions, it is likely that many market participants would err on the side of caution and limit trading when they are in possession of relevant information. As a result, even introduction of a safe harbour is still likely to have a significant effect on the effective functioning of commodity derivative markets.

We would strongly recommend that the existing definition of inside information in relation to commodity derivatives in Article 7(1)(b) should be retained.