

MiFID II / MIFIR

the upcoming financial market regulation in EU/EEA
Effective 3 January 2018

Some frequently asked questions answered
in relation to Trade Members of NOREXECO

Updated 21 December 2017
Kongsvinger, Norway

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This document does not provide or substitute legal advice!

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1. Introduction

The revision of MiFID I, which took the form of a revised Directive, MiFID II, and a new Regulation, MiFIR, is set to change the rules for trading commodity derivatives¹. The general exemption for commodity trading provided by MiFID I will be repealed and replaced by a so-called ancillary activity exemption. With this change, only traders with ancillary activities in trading commodity derivatives will stay outside the scope of MiFID II.

Those who are captured by MiFID II (by exceeding the ancillary activity exemption thresholds) will be categorised as an investment firm, and, as a consequence, will have to comply with many new legal requirements. Moreover, every commodity derivative contract will be subject to position limits and trigger the obligation for market participants as well as trading venues to report positions.

Also for firms which are already subject to MiFID I, the scope of requirements is set to increase.

This Q&A aims at providing an insight in the upcoming requirements that will follow from the application of MiFID II as of 3 January 2018.

While there are several websites that provide overviews and in depth information this Q&A focuses on those requirements particularly relevant for trading in commodity derivatives. More information on how NOREXECO will implement the MiFID II reporting requirements can be found on NOREXECO' website in the section [MiFID II / MiFIR > Reporting](#).

NOREXECO is licensed as a regulated market by the Ministry of Finance of Norway and under supervision of Finanstilsynet/The Financial Supervisory Authority of Norway. The Financial Supervisory Authority of Norway is the National Competent Authority of Norway, also known as the NCA in MiFID II terminology. All EEA countries has a local NCA.

Norway is a member of the EEA, but is not a member of the EU. The new regulation was included in the Norwegian laws as of 4 December and comes into effect on 1 January 2018.

This Q&A does not provide or substitute legal advice. This Q&A only serves information purposes and is intended to be a first practical guide for firms operating in trading in commodity derivatives that have limited experience with MiFID I and MiFID II/MiFIR.

The content is to a certain extent inspired by similar Q&As, the one from European Energy Exchange (EEX) particularly.

¹ In this document, "commodity derivatives" refers to commodity derivatives according to the definition of MiFID II, and derivatives thereof. Only in the context of position limits, it will refer to only commodity derivatives according to the definition of MiFID II.

Background information on the different levels of legislation.

Level	Description	Legal Basis
Level 1	Overarching framework legislation produced using standard co-decision procedure	<p>Directive (EU) No. 2014/65 of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, or simply the Markets in Financial Instruments Directive (MiFID II)</p> <p>Regulation (EU) No. 600/2014 of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, or simply the Market in Financial Instruments Regulation (MiFIR).</p> <ul style="list-style-type: none"> - MiFID II - MiFIR
Level 2	Secondary legislation containing additional definitions and matters of detail, which is produced separately by the European Commission in consultation with ESMA, following the Level 1 legislation.	<p>EC overview of Regulatory Technical Standards (RTSs) and Implementing Technical Standards (ITSs). Once published by the Official Journal, RTSs and ITSs are called Delegated and Implementing Regulations respectively.</p> <p>E.g.:</p> <ul style="list-style-type: none"> - Commission Delegated Regulation (EU) 2017/592 on the ancillary activity exemption, formerly known as RTS 20. - Commission Delegated Regulation (EU) 2017/591 on position limits, formerly known as RTS 21. - Commission Delegated Regulation (EU) 2017/590 on transaction reporting, formerly known as RTS 22.
Level 3	Guidance designed to ensure that EU legislation is applied by the respective competent authorities in EU Member States as consistently as possible. It follows the Level 1 and Level 2 legislation.	<p>ESMA guidelines and Q&As</p> <p>Example: ESMA Q&A on MiFID II and MiFIR commodity derivative topics</p>

Examples of websites of relevant competent financial market regulators

[The European securities and Markets Authority \(ESMA\)](#) web site on MiFID II and MIFIR

[The Norwegian Financial Supervisory Authority's](#) website on MiFID II

[The UK FCA](#) website on MiFID II

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2. FAQ

2.1 Main changes in MiFID II

1. What has been the objective of revising MiFID I?

MiFID I has been reviewed to take into account developments in the trading environment since its implementation in 2007 and, in light of the financial crisis, to improve the functioning of financial markets making them more efficient, resilient and transparent.

2. What are the main changes from MiFID I?

The original scope of MiFID I has been expanded to cover a larger group of companies and financial products. MiFID II will bring the majority of non-equity products into a robust regulatory regime and move a significant part of OTC trading onto regulated platforms. Furthermore, MiFID II strengthens pre- and post-trade transparency requirements, sets new rules for algorithmic trading and introduces position limits for commodity derivatives. Moreover, investor protection has become a key focus of MiFID II.

2.2 Ancillary Activity Exemption

3. Do I need to become MiFID II authorised? Do I need to become an investment firm, according to MiFID II?

MiFID II Art. 1 and 2 outline the scope of firms subject to MiFID II and respectively the exemptions that could be applicable.

It should be noted that per definition in MiFID II a member of an exchange is considered to be a MiFID II Investment firm. A commercial undertaking within the EU/EEA may however make use of the available exemption by annually informing the NCA in their home country.

The ancillary activity exemption (MiFID II Art. 2, par. 1(j)) is particularly relevant for firms trading in commodity derivatives. It exempts persons from becoming an investment firm under MiFID II, if they are dealing on own account, or providing investment services to clients, in commodity derivatives, provided this is an ancillary activity to their main business. Delegated Regulation (EU) 2017/592 (RTS 20) outlines what it means for an activity to be considered ancillary to the main business. In essence, a person dealing in commodity derivatives needs to pass two tests: (1) the market share test and (2) the main business test. Both have to be conducted on an asset class basis. Whereas the first test compares the size of a person's trading activity against the overall trading activity in the European Union, the second one compares the size of the trading activity with the size of the main activity undertaken by the group.

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NOREXECO assumes that all of the industrial companies that are Trade members of NOREXECO most likely qualify to being exempted.

Importantly, every market participant from within the EU/EEA has the obligation to annually notify its national competent financial market regulator, the NCA, that it will make use of the exemption. Please check with your national regulator for further information.

The ESMA Q&A on MiFID II and MiFIR commodity derivative topics, see link on page 3, provides further guidance on the tests. The [ESMA opinion on the market size calculation](#) provides more information on the overall EU trading activity, per asset class.

4. Which transactions count towards the ancillary activity exemption?

This information can be found in MiFID II Art. 2, par. 1(j), Delegated Regulation (EU) 2017/592 (RTS 20) and the ESMA Q&A on MiFID II and MiFIR commodity derivative topics. In general, the tests (or threshold calculations) need to be conducted per asset class. Only transactions in financial instruments count towards the thresholds.

Furthermore, transactions concluded for risk reducing purposes, intra-group transactions and transactions resulting from the fulfilment of a genuine obligation to provide a trading venue with liquidity. i.e. privileged transactions, shall be excluded from the threshold calculations, see Art. 2 par. 4 of MiFID II and ESMA Q&A on MiFID II and MiFIR commodity derivative topics for further reference.

The calculation for determining whether the company can benefit from the ancillary activity exemption in 2018 is based on the transactions from 1 January 2015 to 31 December 2017. Please note that there is a derogation from this time period, as outlined in Delegated Regulation (EU) 2017/592 (RTS 20).

5. As of when can I notify my regulator that I will make use of the ancillary activity exemption?

Some national regulators have already opened their online notification tools. Please check with your national regulator for further information. On the web pages of UK FCA you will find some useful information regarding MiFID II Ancillary activity [exemption notification form](#), please see this [page](#).

2.3 Position limits - updated 21 December 2017

6. I do not need to become a MiFID II investment firm. Do the position limits apply to me?

Yes. Position limits are linked to the contract traded, not to the participant trading the contract. As of 3 January 2018, every group of commodity derivatives contracts, example: BHKP month, quarter and calendar contracts are regarded as a contract group and given a unique 'Venue Product Code'. The NCA of Norway has the power to decide on the position limit, i.e. the size of a net position, which a person can hold in each contract group. The person in this case refers to the end client holding the position, as well as the group entity of this company, regardless of whether or not they are a MiFID II investment firm. Positions in commodity derivative contracts on one trading venue will be aggregated with positions in contracts listed on other trading venues considered to be the same as well as with positions in economically equivalent OTC (EEOTC) contracts. The aggregation and control against the defined position limits will be performed by the NCA of Norway.

7. Are positions held for hedging purposes exempt from position limits? - 21.12.2017

Yes, non-financial entities can make use of an exemption for those positions that are objectively measurable as reducing risks directly relating to the commercial activity of that non-financial entity. Delegated Regulation (EU) 2017/591 (RTS 21) outlines the hedging exemption as well as the application of the exemption. It states that these risk-reducing positions should be deducted from the short and/or long position before netting the gross position. While Delegated Regulation (EU) 2017/591 (RTS 21) outlines the general rules, national regulators might take different approaches to the concrete implementation of these rules.

The NCA of Norway has published [this form, Commodity Position Limits Exemption Application](#), to be used for those who applies for exemption from the position limits.

8. What are the position limits for NOREXECO products? - 21.12.2017

The NCA of Norway has decided on and published the position limits for each of the NOREXECO products BHKP_Europe and NBSK_Europe: 250,000 MT in the spot month (the nearest month contract to expire) and 250,000 MT aggregated over the remaining months. The limits are actually given in the MiFID II term of LOTS: 1 LOT is equal to the minimum tradable volume which is 100 MT, ref Appendix 1 to the Rulebook of OREXECO. If you look into the published position limit tables the BHKP_Europe and NBSK_Europe will you will find 2,500 lots.

The position level is per company group level of the member of NOREXECO.

As ESMA has still to accept the limits proposed by the NCA of Norway, the limits are published subject to ESMA approval.

9. Who will monitor and manage the position limits?

While regulators are required to monitor and manage the position limits based on the position

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reports they receive, NOREXECO will set up an early warning system that will send out an alert when a position in a relevant contract group of listed contracts at NOREXECO is breached. This information will be based on European Commodity Clearing AG's (ECC's) clearing data and hence does not take into account whether the position is held on behalf of a client, whether the position is held for risk-reducing purposes or whether the market participant has an open position in the same contracts on other trading venues or in EEOTC contracts. In the daily reporting of positions, the data may be supplied with client id's and hedge 'flags'.

2.4 Position reporting

10. Who needs to report positions?

The ESMA Q&A on MiFID II and MiFIR commodity derivative topics clarifies that trading venues will report to national regulators positions resulting from transactions concluded on a trading venue, whereas investment firms report to national regulators positions resulting from transactions concluded outside a trading venue, i.e. position in EEOTC. In order for NOREXECO and investment firms to fulfil this obligation, the Trade Members of NOREXECO - regardless of whether or not these are investment firms, MiFID II requires that Trade Members have to provide the trading venue with a complete breakdown of their position. To help non-investment firms (i.e. firms that do not have to be licensed as an investment firm under MiFID II and has notified their regulator) and third-country firms to fulfil their obligation, NOREXECO will provide a daily draft position report that will only require supplementary data from these firms.

The draft will be based on default values of position owner (LEI), owner's MiFID category, ultimate owner (LEI) and whether a position is a hedge or not a hedge. NOREXECO will collect and store the default values from each member.

Moreover, both investment firms and non-investment firms will receive the opportunity to make amendments to the daily position reports on the day following the trading day concerned. Amendments are required only when the default values do not apply.

11. Which IT schema will NOREXECO use for Investment firms to report positions?

NOREXECO assumes that the non financial firms does not have the need to report positions details to NOREXECO as they trade on their own account only. As such, the draft report provided by NOREXECO which is based on the positions booked in the clearing house, ECC, should reflect the actual positions to be reported.

For those who need to report positions to NOREXECO, the enhanced ITS4 schema agreed upon within the industry-working group led by the Futures Industry Association (FIA) and European Federation of Energy Traders (EFET) will be used. Please see our website in the section MIFIDII/MIFIR - Positions.

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2.5 Other questions

12. Are there special requirements for third-country investment firms that trade at NOREXECO?

ESMA is currently in the process of verifying if and how national competent authorities of third countries are in line with the respective MiFID II requirements. This process is not expected to be finalised before 3 January 2018. Therefore, EU Member States and national competent authorities are requested to put in place transitional arrangements.

A third country investment firm doing MiFID II activity are, according to Art. 48 of MiFIR required to register with ESMA. It is unclear what transitional arrangements will be in place by 3 January 2018.

13. Will NOREXECO provide the possibility to flag market making orders?

NOREXECO intends to issue special trading accounts for market participants who are pursuing a market making strategy. All orders and trades on such an account are per default flagged as 'market making'.

14. How will NOREXECO fulfil the pre-trade control requirements?

The MiFID II requirements for pre-trade controls for derivatives markets are:

- Price collar check, which prevents orders with an excessive price difference to a reference price from entering the order book.
- Maximum order quantity validation, which prevents orders with an excessive order size from entering the order book.
- Maximum order value validation, which prevents orders with excessive order values from entering the order book.

NOREXECO monitors the market and defines maximum and minimum order prices on a daily basis. This prevents orders with excessive price differences to be entered into the order book.

NOREXECO has fixed volume limits for different instruments. Current volume limits are 24,000 MT for a single month contract, 6,000 MT per month for a quarter instrument and 2,000 MT per month for a calendar instrument.

The combination of price and volume limits prevents excessive order values to be entered into the order book.

In addition to these market wide limits, each trader may define local limits provided they are within the market wide limits.

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15. Will NOREXECO provide ISINs on contract level?

As required by MiFID II/MiFIR and MAR, NOREXECO has introduced ISINs at contract level to enable a more detailed reporting service based on contract/instrument level.

All NOREXECO's contracts are reported to ESMA's 'Reference data database' - the FIRDS system, and can be retrieved from there. In addition, ISIN codes will be provided on the daily settlement price and open interest files accessible on our FTP site.

16. The transaction and position reporting obligations pursuant to Article 26 par. 5 MiFIR and Article 58 par. 1 MiFID II do not apply to non-investment and third-country firms, why do we have to provide NOREXECO with the respective LEIs and NATIONAL_IDs?

According to Article 26 par. 5 of MiFIR, the trading venues are obliged to report certain transactions in financial instruments as well:

“The operator of a trading venue shall report details of transactions in financial instruments traded on its platform which are executed through its systems by a firm which is not subject to this Regulation in accordance with paragraphs 1 and 3.”

In addition to transaction reporting obligation, NOREXECO is obliged to record, store and keep track of all orders in accordance with Commission Delegated Regulation (EU) 2017/580, RTS 24. The information on every order is quite similar to what is required for transaction reporting as described below.

Non-investment firms and third-country firms are such firms that are not subject to MiFIR. Therefore, NOREXECO is obliged to report transactions in financial instruments concluded on NOREXECO for all these members. The details that have to be reported by NOREXECO is the same details that an investment firm has to report (see Art. 26 par. 3 of MiFIR in conjunction with Commission Delegated Regulation (EU) 2017/590 RTS 22). Thus, the information to be reported includes inter alia the identification codes of the buyer and the seller as well as decision maker and the trader's code. These codes are either the LEI for legal entities or the NATIONAL_ID for natural persons. For non-EEA countries natural person identifiers include name and birth dates

LEIs and NATIONAL_IDs are further needed to complete the respective fields of the daily position reports sent by NOREXECO to the competent authority of Norway in accordance with respective implementing legislation of Art. 58 MiFID II in conjunction with Commission Implementing Regulation (EU) 2017/1093.

In order for NOREXECO to comply with the reporting obligations, non-investment firms and third-country firms that are active on NOREXECO need to provide NOREXECO with the necessary information.

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